



# The Payment Order of Antiquity and the Middle Ages

A Legal History

BENJAMIN GEVA

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## THE PAYMENT ORDER OF ANTIQUITY AND THE MIDDLE AGES

Examining the legal history of the order to pay money initiating a funds transfer, the author tracks basic principles of modern law to those that governed the payment order of Antiquity and the Middle Ages. Exploring the legal nature of the payment order and its underpinning in light of contemporary institutions and payment mechanisms, the book traces the evolution of money, payment mechanisms and the law that governs them, from developments in Ancient Mesopotamia, Ancient Greece, Rome, and Greco-Roman Egypt, through Medieval Europe and post-Medieval England. Doctrine is examined in Jewish, Islamic, Roman, common and civil laws.

Investigating such diverse legal systems and doctrines at the intersection of laws governing bank deposits, obligations, the assignment of debts, and negotiable instruments, the author identifies the common denominator for the evolving legal principles and speculates on possible reciprocity. At the same time he challenges the idea of 'law merchant' as a mercantile creation.

The book provides an account of the evolution of payment law as a distinct cohesive body of legal doctrine applicable to funds transfers. It shows how principles of law developed in tandem with the evolution of banking and in response to changing circumstances and proposes a redefinition of 'law merchant'.

The author points to deposit banking and emerging technologies as embodying a great potential for future non-cash payment system growth. However, he recommends caution in predicting both the future of deposit banking and the overall impact of technology. At the same time he expresses confidence in the durability of legal doctrine to continue to evolve and accommodate future payment system developments.

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Benjamin Geva

# The Payment Order of Antiquity and the Middle Ages

A Legal History

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• H A R T •  
PUBLISHING

OXFORD AND PORTLAND OREGON

2011

Published in the United Kingdom by Hart Publishing Ltd  
16C Worcester Place, Oxford, OX1 2JW  
Telephone: +44 (0)1865 517530  
Fax: +44 (0)1865 510710  
E-mail: [mail@hartpub.co.uk](mailto:mail@hartpub.co.uk)  
Website: <http://www.hartpub.co.uk>

Published in North America (US and Canada) by  
Hart Publishing  
c/o International Specialized Book Services  
920 NE 58th Avenue, Suite 300  
Portland, OR 97213-3786  
USA  
Tel: +1 503 287 3093 or toll-free: (1) 800 944 6190  
Fax: +1 503 280 8832  
E-mail: [orders@isbs.com](mailto:orders@isbs.com)  
Website: <http://www.isbs.com>

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should be addressed to Hart Publishing Ltd at the address above.

British Library Cataloguing in Publication Data  
Data Available

ISBN: 978-1-84946-052-1

Typeset by Hope Services, Abingdon  
Printed and bound in Great Britain by  
TJ International Ltd, Padstow, Cornwall

Dedicated to my wife  
**Esther**  
For whose encouragement and support  
I am obliged





## *Preface*

The book is a product of a prolonged effort over several years. It would not have come out but for the help and support of some institutions and individuals who deserve a special mention. While I assume responsibility for each and every error my gratitude is given particularly to those listed below.

Generous funding for the research was provided by the Social Science and Humanities Research Council of Canada (SSHRCC) under its Standard Research Grants Program. Funding was also provided by the Osgoode Hall Law School through its Research Fellowship as well as through its standard research assistance programmes. The Max-Planck Institute for Comparative and Private International Law, Hamburg, Germany also provided funding. Most of the work was carried out at Osgoode Hall Law School of York University in Toronto. I spent a year on sabbatical working on the project as an Adjunct Professor and Visiting Scholar at Northwestern University School of Law in Chicago. I also spent one semester working on the project at New York University School of Law as a Senior Global Research Fellow at the Hauser Global Visitors Program. I spent shorter periods as a visiting researcher at Max-Planck Institute for Comparative and Private International Law, Hamburg, Germany and at Cambridge University in England where I was a Visiting Fellow at Fitzwilliams College and Visitor at the Faculty of Law. I am grateful to these institutions for the support they provided.

In my research, I used scholarly sources and authoritative texts and documents. Internet sites were visited and are cited particularly for background facts which are common knowledge but also for sources which are hard to get in print. Original documents and sources for the research are in English, French, German, Italian, Hebrew, Greek, Latin, Aramaic, Demotic, Coptic, ancient languages of Mesopotamia, Arabic, Law French, Judeo-Arabic, Flemish, Dutch, and possibly also Spanish, Portuguese, Ottoman Turk and perhaps other languages. From those, unfortunately, I read only English, French, Hebrew, Law French and some Aramaic. Thus I relied only on original and translated materials and sources in those languages. My familiarity with the characters of Arabic and, to a much lesser extent, Greek, alphabets, was of limited assistance as well. Invaluable help in providing unofficial translations of various documents and sources and other linguistic assistance was given by Ricardo Ben-Oliel (Professor at Haifa University, Israel), Filippo Valguarnera (at the time a Global Research Fellow in the Hauser Program at New York University), Francesco Raspini (at the time at the University of Pisa), William Roberds (of the Federal Reserve Bank of Atlanta), Mohammad Fadel (of University of Toronto Faculty of Law), Gina Alexandris at Osgoode and at the Max-Planck Institute for

Comparative and International Private Law in Hamburg. Charles M Dobson, at the time an Osgoode student, assisted both in translation and research. I thank them all for their invaluable assistance.

Bernard Feintuch has been my patient, informative and inspiring guide with whom I have been learning Talmud in Toronto for more than 20 years. As of my sabbatical stay in Chicago during 2005–06, invaluable guidance in Jewish law has also been provided by Kalman Worch. Osgoode students (as each was at his respective time) Elie Zolty, Joseph Salmon, Joseph Juda, and David Fenig provided invaluable research assistance in Talmudic law. My gratitude, accompanied with an apology for anything I might have incorrectly learned, is given to each one of them.

Invaluable research assistance for various parts of the manuscript, at different stages of the work, was also provided by Osgoode students (as they were at the respective times) Muharem Kianieff, Michael Rennie and Sarah E Templeton. Shameela Chinoy assisted me during the preliminary stages of the research. I am grateful to them all.

I am obliged to several Law Librarians who went beyond the call of duty in assisting me to find, obtain and use the vast amount of research materials required for the project. Special mention was earned by Maureen Boyce and her staff at the Interlibrary Loan department at Osgoode Hall Law School, Pegeen G Basset at Northwestern University School of Law, and Sharon Wang, a Reference Librarian at Osgoode. I am also grateful to Yemisi Dina, Nick Pengelley and Tim Knight at Osgoode, to Irene Berkey at Northwestern, as well as to David Warrington, Librarian for Special Collections at Harvard Law School.

I am indebted to numerous colleagues who supported me with advice, direction, encouragement, provision of a good reference, or otherwise. I specifically mention Reinhard Zimmermann of the Max-Planck Institute for Comparative and Private International Law Hamburg, Germany, and Sir Roy Goode of Oxford University in England. Koen Verboven and the late Raymond Bogaert, both of Ghent University, Belgium, introduced me to the world of ancient banking and guided me in researching it. At Cambridge University in England, Avihai Shvitiel introduced me to the Cairo *Geniza*. Åke Lönnberg of the International Monetary Fund and Charles Freedman, formerly of the Bank of Canada and now of Carlton University, coached me in central banking. All mistakes and misunderstandings are of course mine. My gratitude is also extended to Hal S Scott at Harvard, Clayton Gillette at New York University, Richard Hooley at Cambridge, England, Mordechai Rabello of Hebrew University of Jerusalem in Israel, Shalom Lerner and Amnon Altman, both of Bar Ilan University in Israel, Aldo Petrucci of the University of Pisa in Italy, and Oliver Remien of the Julius-Maximilians University of Würzburg, Germany. His colleague Jan-Christoph Marschelke, as well as Richard Stewart of New York University, each provided me with a forum to present and discuss the project.

My Osgoode colleague Craig Scott encouraged me both to apply to SSHRCC for research funding and to submit the manuscript to Hart Publishing, Oxford

where I received invaluable support from Richard Hart himself and his extremely helpful staff, particularly, Rachel Turner, Mel Hamill, Tom Adams and Elissa Connor. Laurie Cormack at Osgoode was extremely helpful in providing advice and help in the preparation of the SSHRCC Research Grant. Assistance in word-processing and formatting of the manuscript was provided at Osgoode by my administrative assistant, Miriam Spevack. Andrea Battiston assisted me in the final editing work. I remain obliged to them all.

Last but not least, this project would not have seen the light of the day had I not benefited from the patience, good advice and encouragement of my family, particularly my wife Esther, to whom I dedicate this work.

\* \* \*

As this study is a product of prolonged effort, some parts of the book bear a resemblance to work previously published by me, albeit possibly in a different structure. Of particular mention are small parts of two earlier books, *Financing Consumer Sales and Product Defences* (Toronto: Carswell, 1984) and *Bank Collections and Payment Transactions* (Oxford: Oxford University Press, 2001), as well as portions of the following articles:

1. 'Equities as to Liability on Bills and Notes: Rights of a Holder Not in Due Course' (1980), 5 *Canadian Business Law Journal* 53.
2. 'The Concept of Payment Mechanism' (1986), 24 *Osgoode Hall Law Journal* 1, (reprinted in Ross Cranston (ed), *Commercial Law* 317 (Aldershot, Hong Kong, Singapore, Sydney: Dartmouth, 1992), being Area 16 of the International Library of Essays in Law and Legal Theory.
3. 'From Commodity to Currency in Ancient History – On Commerce, Tyranny, and the Modern Law of Money' (1987), 25 *Osgoode Hall Law Journal* 115.
4. 'The EU Payment Services Directive: An Outsider's View' (2009), 28 *Yearbook of European Law* 177, Oxford University Press (Eeckhout and Tridimas (eds)).

As well, the following papers, respectively constituting (with some modifications) chapter four, section 2 of chapter two, and chapter six have been previously published as part of the ongoing research leading to the publication of this book:

1. 'Deriving History from Law: Are Cheques Traceable to the Talmud?' (2007), 54 *Revue Internationale Des Droits de l'Antiquité* 27–61 [published at the end of 2008].
2. 'The Monetary Legal Theory Under the Talmud' (2008), 55 *Revue Internationale Des Droits de l'Antiquité* 13–38 [published in early 2010].
3. 'The Medieval Hawale: The Legal Nature of the *Suftaj* and Other Islamic Payment Instruments', to be published online by the Global Hauser Program at New York University School of Law.

\* \* \*

In writing the manuscript, my original intention was to use gender-neutral language. However, during the writing process, I confronted two issues. First, during the period under discussion, banking and commerce were dominated by males. It would have been historically inaccurate to refer to female bankers or businesswomen. As most of that period preceded the business corporation, the option of referring to a bank or business as 'it', for example as utilized in Article 4A of the American *Uniform Commercial Code*, was not available for me. Second, from a purely grammatical point of view, some sentences using gender-neutral language became awkward and hard to read; they became cumbersome, especially when trying to explain multi-party complex situations. For these reasons, I reverted to the use of 'he', 'his', or 'him', albeit endeavouring to avoid the use of gendered pronouns as much as possible.

*Toronto, 19 January 2011*

# Summary of Contents

|                                                                                                               |       |
|---------------------------------------------------------------------------------------------------------------|-------|
| <i>Preface</i>                                                                                                | vii   |
| <i>List of Illustrations</i>                                                                                  | xix   |
| <i>Table of Cases</i>                                                                                         | xxi   |
| <i>Table of Legislation</i>                                                                                   | xxxii |
| <i>International and Miscellaneous Legislation</i>                                                            | xlvi  |
| <i>Prologue</i>                                                                                               | 1     |
| 1. Money, Payment in Money, and the Order to Pay Money                                                        | 15    |
| 2. Money and Monetary Legal Theory in Antiquity and the Middle Ages                                           | 68    |
| 3. Funds Transfers in Antiquity: Instruments, Institutions and Mechanisms                                     | 116   |
| 4. Deriving History from Law: Are Cheques Traceable to the Talmud?                                            | 158   |
| 5. The Payment Order under Roman Law                                                                          | 191   |
| 6. The Medieval <i>Hawale</i> : The Legal Nature of the <i>Suftaj</i> and Other Islamic Payment Instruments   | 252   |
| 7. Funds Transfers under Talmudic Law: Orthodoxy and Adaptation                                               | 307   |
| 8. Payment Orders in Medieval Continental Europe: Book Transfers and Bills of Exchange                        | 352   |
| 9. Payment Orders under English Common Law: The Bailment of Money and the 'Reception' of the Bill of Exchange | 423   |
| 10. Evolution and Transformation: The Birth of the Modern Payment System in Post-Medieval England             | 467   |
| 11. Turning the Wheels of Post-Medieval Change: Paper Circulation and Negotiability under English Law         | 528   |
| 12. Staying on Course: The Footprint of Ancient and Medieval Doctrine and Practice on Modern Payment Laws     | 585   |
| <i>Epilogue:</i>                                                                                              |       |
| From Barter to Electronic Funds Transfers and the Role of Law                                                 | 640   |
| <i>Illustrations</i>                                                                                          | 642   |
| <i>Bibliography</i>                                                                                           | 687   |
| <i>Index</i>                                                                                                  | 713   |



# *Table of Contents*

|                                                               |        |
|---------------------------------------------------------------|--------|
| <i>Preface</i>                                                | vii    |
| <i>List of Illustrations</i>                                  | xix    |
| <i>Table of Cases</i>                                         | xxi    |
| <i>Table of Legislation</i>                                   | xxxii  |
| <i>International and Miscellaneous Legislation</i>            | xlvi   |
| <i>Prologue</i>                                               | 1      |
| 1. The Theme                                                  | 1      |
| 2. The Context                                                | 2      |
| 3. Description                                                | 6      |
| 4. Contribution to Scholarship                                | 10     |
| <br>1. Money, Payment in Money, and the Order to Pay Money    | <br>15 |
| 1. Introduction                                               | 16     |
| 2. Money                                                      | 17     |
| 3. Payment in Money                                           | 25     |
| 3.1 The Meaning of ‘Payment’                                  | 25     |
| 3.2 Tender of Money                                           | 26     |
| 3.3 The Process of Payment: Completion, Risk and Remedies     | 32     |
| 4. The Order to Pay Money: The Concept of a Payment Mechanism | 37     |
| 4.1 Transmission of Monetary Value: General Framework         | 37     |
| (i) The Basic Model                                           | 37     |
| (ii) The Three-party Payment Mechanism                        | 39     |
| (iii) Multipartite-payment Mechanisms                         | 45     |
| 4.2 Transmission of Monetary Value: Legal Issues              | 47     |
| (i) Introductory Notes                                        | 47     |
| (ii) Three-party Payment Mechanism                            | 47     |
| <i>The Issues</i>                                             | 47     |
| <i>First and Second Issues: Paymaster’s Duties towards</i>    |        |
| <i>Debtor and Creditor</i>                                    | 49     |
| <i>Second Issue: Scope of Creditor’s Entitlement</i>          | 52     |
| <i>Third Issue: Debtor’s Discharge</i>                        | 54     |
| <i>Fourth Issue: Paymaster’s Discharge</i>                    | 55     |
| <i>Discharge: Summary</i>                                     | 56     |
| (iii) Four-party Money-transmitter Payment Mechanisms         | 56     |
| (iv) Four-party Banker Payment Mechanisms                     | 58     |

|           |                                                                                                             |            |
|-----------|-------------------------------------------------------------------------------------------------------------|------------|
| 4.3       | Conclusion                                                                                                  | 60         |
| 4.4       | Addendum: Payment by <b>Paymaster's</b> Obligation and the Evolution of Modern Payment Mechanisms           | 61         |
| <b>2.</b> | <b>Money and Monetary Legal Theory in Antiquity and the Middle Ages</b>                                     | <b>68</b>  |
| 1.        | Money in Antiquity and the Middle Ages                                                                      | 68         |
| 1.1       | Overview                                                                                                    | 68         |
| 1.2       | Origins                                                                                                     | 73         |
| 1.3       | Expansion                                                                                                   | 81         |
| 1.4       | Debasement and Transformation                                                                               | 87         |
| 2.        | The Monetary Legal Theory under the Talmud                                                                  | 92         |
| 2.1       | Introduction                                                                                                | 92         |
| 2.2       | Coins as Money and Ordinary Chattels: The Legal Nature of the Money Change Transaction                      | 97         |
| 2.3       | Coins Valued on Basis of Metal: Effect of Erosion                                                           | 101        |
|           | (i) Introduction                                                                                            | 101        |
|           | (ii) Deficient Coins as Money                                                                               | 103        |
|           | (iii) Erosion to the Limit of Fraud                                                                         | 103        |
|           | (iv) Erosion Beyond the Limit of Fraud                                                                      | 105        |
| 2.4       | Property Rules Applicable to Coins: Facilitating Circulation                                                | 107        |
| 2.5       | Conclusion                                                                                                  | 110        |
| 3.        | From Metallism to Nominalism: Evolution of Monetary Legal Theory in Roman Law and the Common Law of England | 111        |
| 4.        | Concluding Remarks                                                                                          | 115        |
| <b>3.</b> | <b>Funds Transfers in Antiquity: Instruments, Institutions and Mechanisms</b>                               | <b>116</b> |
| 1.        | Introduction                                                                                                | 116        |
| 2.        | Ancient Mesopotamia                                                                                         | 118        |
| 3.        | Ancient Greece                                                                                              | 124        |
| 4.        | Ancient Rome                                                                                                | 132        |
| 5.        | Greco-Roman Egypt                                                                                           | 140        |
| 6.        | Summary                                                                                                     | 155        |
| <b>4.</b> | <b>Deriving History from Law: Are Cheques Traceable to the Talmud?</b>                                      | <b>158</b> |
| 1.        | Introduction                                                                                                | 158        |
| 2.        | Directing a Creditor to a Paymaster: The <i>Bava Metzia</i> Text                                            | 161        |
| 2.1       | The Talmudic Text in <i>Bava Metzia</i> : Credit Extended by Paymaster                                      | 161        |
| 2.2       | Tosafot's Commentary – Renunciation of Recourse                                                             | 165        |
| 2.3       | Other Commentators – Elaborating Tosafot's Discussion                                                       | 172        |



|      |                                                                                                                |     |
|------|----------------------------------------------------------------------------------------------------------------|-----|
| 2.4  | Which Scenario? – Aspects of Tosafot’s Analysis Revisited                                                      | 176 |
| 2.5  | Talmudic Text in <i>Shevuot</i> – Tosafot’s Position Supported                                                 | 178 |
| 3.   | Final Modern Lawyer’s Observations                                                                             | 184 |
|      | Appendix: Glossary of Post-Talmudic Jewish Law Sources                                                         | 186 |
| 5.   | <b>The Payment Order under Roman Law</b>                                                                       | 191 |
| 1.   | The Order to Pay and Compliance: An Overview                                                                   | 191 |
| 2.   | The Debt Owed by <b>Paymaster</b> to <b>Debtor</b>                                                             | 194 |
| 3.   | The Legal Nature of the Delegation Order                                                                       | 201 |
| 4.   | Executing the Delegation: Introduction                                                                         | 208 |
| 5.   | Imperfect Execution: <i>Receptum</i> and <i>Constitutum</i>                                                    | 210 |
| 6.   | Perfect Execution of the Delegation: Novation by Stipulation                                                   | 214 |
| 6.1  | Enforceability by <b>Creditor</b> of <b>Paymaster’s</b> Undertaking                                            | 214 |
| 6.2  | Scope and Impact of <b>Paymaster’s</b> Undertaking                                                             | 217 |
| 7.   | Perfect Execution of the Delegation: Novation Other than by Stipulation                                        | 223 |
| 7.1  | <i>Litis Contestatio</i>                                                                                       | 223 |
| 7.2  | Acknowledgment of an Entry Posted to ‘ <i>Codex Accepti et Expensi</i> ’                                       | 225 |
| 8.   | All Cards Shuffled: Delegation under the Reform Projects of Justinian                                          | 229 |
| 9.   | Cession: An Alternative to Delegation                                                                          | 233 |
| 10.  | Roman Law and Practice: Multipartite Applications of the Mechanisms                                            | 241 |
| 10.1 | Introduction                                                                                                   | 241 |
| 10.2 | Circulation of Credit                                                                                          | 242 |
| 10.3 | Payment to a Distant Party                                                                                     | 244 |
| 11.  | Final Observations: The Uncertain Heritage of Roman Law                                                        | 246 |
| 6.   | <b>The Medieval <i>Hawale</i>: The Legal Nature of the <i>Suftaj</i> and Other Islamic Payment Instruments</b> | 252 |
| 1.   | Introduction: Banking and Payment Institutions in the Medieval Islamic World                                   | 252 |
| 2.   | Transfer of Debt under Islamic Law: The <i>Hawale</i>                                                          | 257 |
| 2.1  | The Mandate for Collection and the <i>Hawale</i> Concept                                                       | 257 |
| 2.2  | The <i>Hawale</i> in Legal Doctrine                                                                            | 259 |
| 1.   | Who are the parties to the <i>hawale</i> agreement?                                                            | 261 |
| 2.   | Is the transferee (paymaster) to be indebted to the transferor (original debtor)?                              | 262 |
| 3.   | Is recourse available to the creditor against the transferor (original debtor)?                                | 263 |

|                                                                                                                          |            |
|--------------------------------------------------------------------------------------------------------------------------|------------|
| 4. What are the transferee (paymaster)'s defences?                                                                       | 265        |
| 5. What securities are available to the creditor?                                                                        | 266        |
| 2.3 Codification of Hanafi Law: The <i>Hawale</i> under the Mejlle                                                       | 268        |
| 3. The <i>Suftaj</i> and Other Islamic Payment Instruments: The <i>Hawale</i><br>Applied                                 | 277        |
| 3.1 Islamic Payment Instruments and the <i>Hawale</i> : An Overview                                                      | 277        |
| 3.2 The <i>Suftaj</i> under <i>Hawale</i> Principles                                                                     | 284        |
| 3.3 The Legal Nature and Operation of the <i>Suftaj</i>                                                                  | 290        |
| 3.4 The Objections to the <i>Suftaj</i>                                                                                  | 299        |
| 4. Conclusion: <i>Hawale</i> , <i>Suftaj</i> and the Bill of Exchange                                                    | 301        |
| <b>7. Funds Transfers under Talmudic Law: Orthodoxy and Adaptation</b>                                                   | <b>307</b> |
| 1. Introduction                                                                                                          | 307        |
| 2. Transfer of Ownership in Money Owed                                                                                   | 309        |
| 2.1 Money Owed on Loan or Deposit                                                                                        | 309        |
| 2.2 Direct Mechanisms for the Transfer of Money Owed                                                                     | 312        |
| 2.3 Transfer of Money Owed by Authorizing the Creditor to<br>Collect from the Paymaster: The <i>Urcheta</i>              | 321        |
| 2.4 Transfer of Money Owed by Turning the Creditor's Agent<br>to a Paymaster: The <i>Dyokani</i>                         | 326        |
| 2.5 Summary                                                                                                              | 329        |
| 3. Instructing a Paymaster to Pay the Creditor Money Owed by<br>Means of a Presence-of-all-three Declaration             | 330        |
| 4. Remitting Coins to a Distant Place: The <i>Dyokani</i> Transformed                                                    | 342        |
| 5. Conclusion: The Talmudic Contribution                                                                                 | 350        |
| <b>8. Payment Orders in Medieval Continental Europe: Book Transfers<br/>and Bills of Exchange</b>                        | <b>352</b> |
| 1. Introduction: Bankers, Banking and Payments in Medieval<br>Continental Europe                                         | 352        |
| 2. Deposit and Transfer Banking in Medieval Continental Europe                                                           | 357        |
| 3. Heralding the Bill of Exchange: The Medieval Continental Bill<br>of Payment                                           | 369        |
| 4. The Bill of Payment: Legal Relationships                                                                              | 387        |
| 5. Negotiability Acquired: The Continental Bill of Exchange in the<br>Early Post-Medieval Era                            | 401        |
| 6. Conclusion: Medieval Continental Contribution Assessed                                                                | 418        |
| <b>9. Payment Orders under English Common Law: The Bailment of<br/>Money and the 'Reception' of the Bill of Exchange</b> | <b>423</b> |
| 1. Introduction                                                                                                          | 423        |
| 2. Bailment of Money and the Bailor-Bailee Relationship                                                                  | 425        |

|                                                                                                                  |     |
|------------------------------------------------------------------------------------------------------------------|-----|
| 3. The Beneficiary's Right to Bailed Funds                                                                       | 433 |
| 4. The 'Reception' of the Bill of Exchange – Payee's Remedy                                                      | 442 |
| 5. The Bailment of Money and the Bill of Exchange as Payment<br>Mechanisms: A Comparison                         | 453 |
| 6. Conclusion                                                                                                    | 464 |
| <b>10. Evolution and Transformation: The Birth of the Modern Payment<br/>System in Post-Medieval England</b>     | 467 |
| 1. Introduction                                                                                                  | 467 |
| 2. The Goldsmiths' System: Banknotes, Cheques, and Banking<br>Network                                            | 469 |
| 2.1 Introduction                                                                                                 | 469 |
| 2.2 Goldsmith Banking Operations: Notes, Cheques and Bill<br>Discounting                                         | 471 |
| 2.3 Goldsmith Banking System: The Network                                                                        | 481 |
| 3. Bank of England: Note Issue, Cheque Settlement and Central<br>Banking                                         | 484 |
| 3.1 Introduction                                                                                                 | 484 |
| 3.2 Bank of England Notes                                                                                        | 487 |
| 3.3 Bank of England Becomes a Settlement Bank                                                                    | 492 |
| 3.4 Bank of England Becomes a Central Bank                                                                       | 497 |
| 4. Paper Money and the Promise to Pay Money: Are Banknotes<br>'Promissory Notes'?                                | 505 |
| 5. Gold Reduced to Paper and Entries to Accounts: Metallism,<br>Nominalism, Paper Money and Bank Money           | 518 |
| <b>11. Turning the Wheels of Post-Medieval Change: Paper Circulation and<br/>Negotiability under English Law</b> | 528 |
| 1. Introduction                                                                                                  | 528 |
| 2. Negotiation of Bills Payable to Order                                                                         | 531 |
| 3. Negotiation of Notes Payable to Order                                                                         | 533 |
| 4. Negotiation of Instruments Payable to the Bearer                                                              | 541 |
| 5. Negotiation of Cheques                                                                                        | 547 |
| 6. Negotiation and Material Negotiability: Circulation Free from<br>Claims and Defences                          | 552 |
| 6.1 Introduction                                                                                                 | 552 |
| 6.2 Freedom from Adverse Claims                                                                                  | 554 |
| 6.3 Freedom from Contract Defences                                                                               | 568 |
| 7. Conclusion: Final Reflections on 'Negotiation' and 'Negotiability'                                            | 582 |

|                                                                                                                  |            |
|------------------------------------------------------------------------------------------------------------------|------------|
| <b>12. Staying on Course: The Footprint of Ancient and Medieval Doctrine and Practice on Modern Payment Laws</b> | <b>585</b> |
| 1. Introduction                                                                                                  | 585        |
| 2. Payment Services and their Providers                                                                          | 587        |
| 3. The Bank Deposit                                                                                              | 596        |
| 4. The Payment Order and its Execution under Modern Law                                                          | 604        |
| 5. The Payment Order as a Mandate                                                                                | 612        |
| 6. Paymaster's Obligation: Autonomy and Discharge                                                                | 622        |
| 7. Conclusion: A 'Revisionist' View on a 'Decentralized' Non-customary 'Law Merchant'                            | 637        |
| <i>Epilogue: From Barter to Electronic Funds Transfers and the Role of Law</i>                                   | 640        |
| <i>Illustrations</i>                                                                                             | 642        |
| <i>Bibliography</i>                                                                                              | 687        |
| <i>Index</i>                                                                                                     | 713        |

## *List of Illustrations*

|                                                                                                                    |     |
|--------------------------------------------------------------------------------------------------------------------|-----|
| 1. General Key                                                                                                     | 642 |
| 2. Operation of a Payment Mechanism                                                                                | 643 |
| 3. Payment through the Banking System                                                                              | 644 |
| 4. Payment Mechanism: Major Legal Issues                                                                           | 645 |
| 5. Clearing and Settlement Systems in the National Economy<br>[Prologue and chapter ten]                           | 646 |
| 6. Participants in the Domestic Payment System [Prologue and<br>chapter ten]                                       | 647 |
| 7. The International Payment System [Prologue and chapter ten]                                                     | 648 |
| 8. The Cheque                                                                                                      | 649 |
| 9. Funds Transfers                                                                                                 | 650 |
| 10. Debit Transfers                                                                                                | 651 |
| 11. Credit Transfers                                                                                               | 652 |
| 12. Payment Transaction                                                                                            | 653 |
| 13. Interbank Clearing and Settlement – I                                                                          | 654 |
| 14. Interbank Clearing and Settlement – II                                                                         | 655 |
| 15. Delegation and Cession in Roman Law [chapter five]                                                             | 656 |
| 16. Circulation of Credit in Ancient Rome [chapter five]                                                           | 657 |
| 17. Roman Law in Practice: Payment to a Distant Party [chapter five]                                               | 658 |
| 18. Parties to Islamic <i>Hawale</i> [chapter six]                                                                 | 659 |
| 19. Islamic <i>Suftaj</i> : [chapter six (and seven)]                                                              | 660 |
| 20. Talmudic ‘Unilateral’ Deposit-transfers [chapter seven]                                                        | 661 |
| 21. The Talmudic <i>Urcheta</i> [chapter seven]                                                                    | 662 |
| 22. The Talmudic <i>Dyokani</i> [chapter seven]                                                                    | 663 |
| 23. Talmudic <i>Dyokani</i> Turns <i>Suftaj</i> [chapter seven]                                                    | 664 |
| 24. Parties to the Four-party Medieval Bill of Payment in the Continent<br>– ‘Export [trade] Bill’ [chapter eight] | 665 |
| 25. Four-party Medieval Bill of Payment in the Continent – ‘Export<br>[trade] Bill’ [chapter eight]                | 666 |
| 26. Four-party Medieval Bill of Payment in the Continent – Remittance<br>Bill [chapter eight]                      | 667 |
| 27. Four-party Medieval Bill of Payment in the Continent – Remittance<br>Bill [chapter eight]                      | 668 |
| 28. Bills ‘Put Over’ before They are Made: Malynes’ Scenario [chapter<br>eight]                                    | 669 |
| 29. Bill Discounting [chapters eight–eleven]                                                                       | 670 |
| 30. A Seventeenth-Century Inland Bill of Exchange in England [chapters<br>eight and nine]                          | 671 |

|                                                                                                          |     |
|----------------------------------------------------------------------------------------------------------|-----|
| 31. <i>Burton v Davy</i> [chapters nine and eleven]                                                      | 672 |
| 32. <i>Chat and Edgar Case</i> [chapters nine and eleven]                                                | 673 |
| 33. Discountable Bill/Trade Acceptance in International Trade<br>[chapter ten]                           | 674 |
| 34. Model Central Bank Balance Sheet [chapter ten]                                                       | 675 |
| 35. Regulation of Money Supply [chapter ten]                                                             | 676 |
| 36. Cheque in a Setting                                                                                  | 677 |
| 37. Payment and Collection of Cheques – I                                                                | 678 |
| 38. Payment and Collection of Cheques – II                                                               | 679 |
| 39. Negotiable Instruments – Principal Features [chapter eleven]                                         | 680 |
| 40. Negotiability [chapter eleven]                                                                       | 681 |
| 41. Parties to Negotiable Instrument Payable to Order [chapter eleven]                                   | 682 |
| 42. Statutory Protection to Buyer of Goods from Lawful Possessor w/o<br>Title [chapter eleven]           | 683 |
| 43. A Typical Itinerary for Incoming Cross-border Wire-transfer in<br>Domestic Currency [chapter twelve] | 684 |
| 44. Epilogue: Evolution of Money and Payment Systems                                                     | 685 |

# Table of Cases

## AUSTRALIA

|                                                                                    |     |
|------------------------------------------------------------------------------------|-----|
| ANZ Banking Group Ltd v Westpac Banking Corp (1988) 78 ALR 157<br>(Aust. HC) ..... | 29  |
| Comptroller of Stamps (Victoria) v Howard-Smith (1936) 54 CLR 614.....             | 50  |
| Riedell v Commercial Bank of Australia [1931] VLR 382 (SC).....                    | 612 |

## CANADA

|                                                                                                                                                                    |                                             |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------|
| Agricultural Credit Corp of Saskatchewan v Pettyjohn [1991] 3 WWR 689<br>(Sask. CA).....                                                                           | 559                                         |
| Alberta Legislation, Re [1938] 2 DLR 81 (SCC), <i>aff'd sub nom</i> AG Alta v<br>AG Can [1939] AC 117 (PC) .....                                                   | 26                                          |
| Bank of Canada v Bank of Montreal (1977), [1978] 1 S.C.R. 1148, 76 DLR<br>(3d) 385 (S.C.R.) .....                                                                  | 506, 509, 510, 511, 514, 515, 516, 517, 522 |
| Bank of Montreal v Bay Bus Terminal (North Bay) Ltd, <i>sub nom</i> (1972)<br>30 DLR (3d) 24 (Ont. CA) .....                                                       | 514, 515                                    |
| Bank of Nova Scotia v Wu, unreported, judgment 23 June 1987 (Ont. DC)....                                                                                          | 29                                          |
| BNS v Angelica Whitewear (1987) 36 DLR (4th) 161 (SCC) .....                                                                                                       | 63                                          |
| Capital Associates Ltd v Royal Bank of Canada (1970) 15 DLR (3d) 234<br>(Que. SC), <i>aff'd</i> (1973) 36 DLR (ed) Que. (CA), (1976) 65 DLR (3d) 384<br>(SCC)..... | 153                                         |
| Caradoc Nurseries Ltd v Marsh (1959) 19 DLR (2d) 491 (Ont. CA).....                                                                                                | 32                                          |
| General Motors Acceptance Corp of Canada Ltd v Bank of Nova Scotia<br>(1986) 55 O.R. (2d) 438 (CA) .....                                                           | 561                                         |
| National Bank of Canada v Tardivel Associates (1993) 15 O.R. (3d) 188<br>(Gen. Div), <i>aff'd</i> (1994) 17 O.R. (3d) 61 (Div. Ct.).....                           | 628                                         |
| Queen, The v Brown (1854) 8 N.B.R. 13 (N.B.S.C.) .....                                                                                                             | 510                                         |
| Range v Belvédère Finance Corp [1969] S.C.R. 492, (1969) 5 DLR (3d)<br>257.....                                                                                    | 541                                         |
| Serca Foodservice Inc v Canadian Imperial Bank of Commerce [2000]<br>O.J. No. 2171, 7 B.L.R. (3d) 47 .....                                                         | 628                                         |
| Toronto Beaches Election, Re, Ferguson v Murphy (1943), [1944] 1 DLR<br>204 (Ont. HC).....                                                                         | 510                                         |
| Western Canada Pulpwood and Lumber Co Ltd, Re [1929] 3 WWR 544<br>(Man. CA) .....                                                                                  | 32                                          |

## CYPRUS

|                                                                             |          |
|-----------------------------------------------------------------------------|----------|
| Constantine Emilianides v Aristodemo Sophocli (1910) 9 Cypr. L.R. 115 ..... | 257      |
| Hussein Mustafa v Osman Ismael (1909) 8 Cypr. L.R. 125 .....                | 269, 271 |
| Imperial Ottoman Bank v Limbouri (1897) 4 Cypr. L.R. 48 .....               | 269      |

## ISRAEL

|                                                                                  |     |
|----------------------------------------------------------------------------------|-----|
| CA 352/58, Levin v Rehovot, 45 P.E. (S.C.J.) 196 (Supreme Court of Israel) ..... | 271 |
| CA 492/60, Moral v Karbatzov, 15 PD 1776 .....                                   | 269 |

## NEW ZEALAND

|                                                                             |        |
|-----------------------------------------------------------------------------|--------|
| Balmoral Supermarket Ltd v Bank of New Zealand [1974] 2 NZLR 155 (SC) ..... | 35, 37 |
| Yan v Post Office Bank Ltd [1994] 1 NZLR 154 (CA) .....                     | 460    |

## PALESTINE (BRITISH MANDATE)

|                                                                                                       |     |
|-------------------------------------------------------------------------------------------------------|-----|
| CA 96/42, Kremenetzky (Administrator of the Estate) v Anglo-Palestine Bank, 9 P.L.R. 559 (S.C.) ..... | 271 |
| CC Haifa 187/46, Palestine Land Development Co v Yalonetsky, 1947 S.C.D.C. 91 .....                   | 271 |

## SOUTH AFRICA

|                                                |     |
|------------------------------------------------|-----|
| Smith, <i>ex parte</i> , 1940 O.P.D. 120 ..... | 197 |
|------------------------------------------------|-----|

## UNITED KINGDOM

|                                                                                                   |          |
|---------------------------------------------------------------------------------------------------|----------|
| A/S Awilco v Fulvia SPA di Navigazione ( <i>The Chikuma</i> ) (1981) 1 Lloyd's Rep 371 (HL) ..... | 59, 623  |
| Abingdon v Martin (1293), <i>reprinted</i> (1908) 23 Selden Soc. 65 .....                         | 542      |
| Afovos Shipping Co SA v Pagnan, <i>The Afovos</i> [1982] 3 All ER 18 (CA) .....                   | 28       |
| Alexander v Brown (1824) 1 Car. & P. 288, 171 E.R. 1199 (NP) .....                                | 27       |
| Anglo-Italian Bank v Wells (1878) 38 L.T. 197 (CA) .....                                          | 573      |
| Anon (1294) Y.B. 21 & 22 Ed. I (R.S.) 598 .....                                                   | 426, 427 |
| Anon (1305–07) Y.B. 33–35 Edw. I (R.S.) 238 .....                                                 | 435      |



|                                                                                |                                                     |
|--------------------------------------------------------------------------------|-----------------------------------------------------|
| Anon (1308) Y.B. 1 & 2 Ed. II .....                                            | 434                                                 |
| Anon (1309) Y.B. 2 & 3 Ed. II .....                                            | 434                                                 |
| Anon (1317–18) Y.B. 11 Ed. II .....                                            | 434, 435                                            |
| Anon (1339) Y.B. 12 & 13 Ed. III (R.S.) 244 .....                              | 426, 437                                            |
| Anon (1368) Y.B. Pasch. 41 Ed. III, f.10, pl. 5 .....                          | 426, 427, 431, 432,<br>435, 439, 440, 441, 454, 597 |
| Anon (1379) Bellewe 59, 72 E.R. 25 .....                                       | 444                                                 |
| Anon (1379) Bellewe 110, 72 E.R. 47 .....                                      | 444                                                 |
| Anon (1385) Bellewe 111, 72 E.R. 47 .....                                      | 570                                                 |
| Anon (1439) 18 Hen. VI, M.f. 20, pl. 5 .....                                   | 428                                                 |
| Anon (1441) Y.B. 19 Hen. VI, 5, pl. 10 .....                                   | 430                                                 |
| Anon (1458) Y.B. 36 Hen. VI, f.9, pl. 5 .....                                  | 435, 436                                            |
| Anon (1467) 6 Edw. IV, H.f. 61, pl. 6 .....                                    | 428                                                 |
| Anon (1479) Y.B. Hil. 18 Ed. 4, f.23, pl. 5 .....                              | 436                                                 |
| Anon (1484) 2 Ric. III, M.f. 14, pl. 39 .....                                  | 428                                                 |
| Anon (1505) Y.B. Mich. 20 Hen. VII, f. 8, pl. 18 .....                         | 431, 436, 439                                       |
| Anon (1528) Y.B. 19 Hen. VIII, f.3, pl. 15 .....                               | 436                                                 |
| Anon (1573) 3 Leon. 38, 74 E.R. 526 .....                                      | 428                                                 |
| Anon (1619) 3 Leon. 38, 74 E.R. 526 .....                                      | 558                                                 |
| Anon (1668) Hardres 485, 145 E.R. 560 ('Milton's Case') .....                  | 455, 456, 537                                       |
| Anon (1694) Holt KB 115, 90 E.R. 962 .....                                     | 451, 452, 531, 535                                  |
| Anon (1696) Holt KB 296, 90 E.R. 1063 .....                                    | 452                                                 |
| Anon (1697) 1 Comyns. 43, 92 E.R. 950 (CA) .....                               | 575                                                 |
| Anon (1699) 3 Salk. 71, 91 E.R. 698 .....                                      | 546, 555, 556, 557, 560                             |
| Anon (1701) Holt KB 298, 90 E.R. 1064 .....                                    | 478, 479, 631, 632                                  |
| Ayres v Moore [1940] 1 KB 278 (CA) .....                                       | 460, 580                                            |
| Baker v Lambert, <i>reprinted</i> (1929) 46 Selden Soc. 2 .....                | 459, 568, 569                                       |
| Banco de Portugal v Waterlow and Sons Ltd [1932] AC 452<br>(HL) .....          | 509, 511, 512, 513, 516, 517, 519, 563              |
| Bank of England v Anderson (1837) 3 Bing. (N.C.) 589, 132 E.R. 538 (CP) ..     | 488                                                 |
| Bank of England v Newman (1700) 12 Mod. 241, 88 E.R. 1290 .....                | 479, 632                                            |
| Banks v Colwell (1788) (Launceston Spring Assizes) .....                       | 577                                                 |
| Banque Belge Pour L'Etranger v Hambrouck [1921] 1 KB 321 (CA) .....            | 54                                                  |
| Barclays Bank v Bank of England [1985] 1 All ER 385 .....                      | 612                                                 |
| Barclays Bank v WJ Simms Son & Cooke (Southern) [1980]<br>QB 677 .....         | 186, 613, 618                                       |
| Barnaby v Rigalt (1635) Cro. Car. 301, 79 E.R. 864 .....                       | 449, 458                                            |
| Beaulieu v Finglam (1401) Y.B. 2 Hen. 4, f.18, pl. 6 .....                     | 450                                                 |
| Beckingham and Lambert v Vaughan (1616) 1 Rolle Rep. 391,<br>81 E.R. 557 ..... | 454                                                 |
| Bishop v Viscountess Montague (1601) Cro. Eliz. 824, 78 E.R. 1051 .....        | 558                                                 |
| Black v Smith (1791) Peake 121, 170 E.R. 101 (Lilly Assize) .....              | 27                                                  |
| Blackburne, <i>ex parte</i> (1804) 10 Ves. Jun. 204, 32 E.R. 823 .....         | 480                                                 |
| Blyth Shipbuilding and Dry Docks Co Ltd, In Re [1926] Ch 494 (CA) .....        | 32                                                  |

|                                                                                                                                                     |                                                |
|-----------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------|
| Boehm v Sterling (1797) 2 Esp. 575, 170 E.R. 460, 7 T.R. 423,<br>101 E.R. 1055 .....                                                                | 547, 548, 577                                  |
| Brady v Jones (1823) 2 Dow. & Ryl. 305.....                                                                                                         | 27                                             |
| Bretton v Barnet (1599) Owen 86, 74 E.R. 918<br>(KB).....                                                                                           | 42, 429, 431, 453, 597, 598                    |
| Brimnes Tenax Steamship Co Ltd, The v The Brimnes (Owners) [1973]<br>1 All ER 769 (QB), <i>aff'd on that point</i> [1974] 3 All ER 88<br>(CA) ..... | 59, 186, 524, 622, 623                         |
| British Linen Co v Hay & Robertson and Brown (1885) 22 SLR 542<br>(First Division) .....                                                            | 240, 635                                       |
| Broken Hill Proprietary Company Ltd v Latham [1933] 1 Ch. 373 (CA) .....                                                                            | 520                                            |
| Brown v Davies (1789) 3 T.R. 80, 100 E.R. 466 .....                                                                                                 | 577                                            |
| Brown v London (1670) 1 Vent. 152, 86 E.R. 104; 1 Mod. 285,<br>86 E.R. 889.....                                                                     | 449, 454, 458                                  |
| Brown v Marsh (1721) Gilb. Rep. 154, 25 E.R. 108 .....                                                                                              | 535                                            |
| Browne v London (1670) 1 Mod. 285, 86 E.R. 889.....                                                                                                 | 455, 456, 537                                  |
| Brun St Mitchel v Troner (1275), <i>reprinted</i> (1888) 2 Selden Soc. 152.....                                                                     | 542                                            |
| Buller v Crips (1703) 6 Mod. 29, 87 E.R. 793.....                                                                                                   | 537, 538, 539                                  |
| Burton v Davy (1437) 49 Selden Soc. 3 .....                                                                                                         | 442, 443, 445, 449,<br>459, 460, 543, 569, 672 |
| Calico Printers' Association Ltd v Barclays Bank Ltd (1930)<br>38 Lloyd's Rep. 105.....                                                             | 620                                            |
| Camidge v Allenby (1827) 6 B. & C. 373, 108 E.R. 489.....                                                                                           | 480                                            |
| Carlos v Fancourt (1794) 5 T.R. 482; 101 E.R. 272.....                                                                                              | 533, 541, 569                                  |
| Case de Mixt Moneys (1605) Davis 18, 80 E.R. 507<br>(KB).....                                                                                       | 88, 93, 113, 114, 518, 521                     |
| Case of the Marshalsea (1455) Y.B. Hil. 33 Hen. 6, f. 1. pl. 3 .....                                                                                | 429                                            |
| Chambers v Miller (1862) 13 C.B. (N.S.) 125, 143 E.R. 50 (CP).....                                                                                  | 33, 34, 35, 36                                 |
| Charge Card Services Ltd, In Re [1988] 3 All ER 702<br>(CA) .....                                                                                   | 55, 66, 185, 388, 625, 626                     |
| Chat and Edgar Case (1663) 1 Keble 636, 83 E.R. 1156.....                                                                                           | 399, 447,<br>448, 451, 532, 673                |
| Cheney v Alisand, executor of J Flint (1425) 4 Hen. VI, M.f. 2, pl. 4.....                                                                          | 428                                            |
| Cheshire & Co v Vaughan Bros & Co [1920] 3 KB 240.....                                                                                              | 620                                            |
| Clark's Case (1614) Godb. 210, 78 E.R. 128 .....                                                                                                    | 438                                            |
| Claxton v Swift (1685) 3 Mod. 86, 87 E.R. 55 .....                                                                                                  | 451, 531                                       |
| Clerk v Mundall (1700) 12 Mod. 203, 88 E.R. 1263 .....                                                                                              | 479, 632                                       |
| Clerke v Martin (1702) 2 Ld. Raym. 757, 92 E.R. 6.....                                                                                              | 534, 535, 536,<br>537, 539, 540, 545           |
| Coggs v Bernard (1703) 2 Ld. Raym. 909, 92 E.R. 107 .....                                                                                           | 310, 430                                       |
| Colonial Bank v Cady (1890) 15 AC 267 (HL) .....                                                                                                    | 565                                            |
| Colonial Bank of Australasia v Marshall [1906] AC 559 (PC) .....                                                                                    | 618                                            |
| Cooksey v Boverie (1693) 2 Show. KB 296, 89 E.R. 949 .....                                                                                          | 477                                            |
| Core v May (1536–37) (1537) Spel. Rep. Vol I.....                                                                                                   | 436                                            |

|                                                                                                      |                                               |
|------------------------------------------------------------------------------------------------------|-----------------------------------------------|
| Core's Case (1537) 1 Dyer 20a, 73 E.R. 42 (KB) .....                                                 | 42, 428, 431,<br>432, 439, 441, 454, 597, 598 |
| Cramlington v Evans (1689) 1 Show KB 4, 89 E.R. 410 .....                                            | 534                                           |
| Crouch v The Credit Foncier of England (1873) LR 8 (QB) 374 .....                                    | 351, 461                                      |
| Cundy v Lindsay (1878) 3 AC 459 .....                                                                | 565                                           |
| Currie v Misa (1875) LR 10 Ex 153 .....                                                              | 22, 489                                       |
| Curteis v Geoffrey de St Romain (1287), <i>reprinted</i> (1908) 23 Selden<br>Soc. 26 .....           | 542                                           |
| Cutting v Williams (1702) 7 Mod. 154; 87 E.R. 1160 .....                                             | 534                                           |
| Dean v James (1833) 4 B. & AD. 546, 110 E.R. 561 (KB) .....                                          | 27                                            |
| Dearie v Hall (1828) 3 Russ. 1, 38 E.R. 475 .....                                                    | 425                                           |
| Dickinson v Shee (1801) 4 Esp. 67, 170 E.R. 644 (Lilly Assizes) .....                                | 27                                            |
| Dixon v Clark (1848) 5 C.B. 365, 136 E.R. 919 (CP) .....                                             | 26                                            |
| Dixon v Willows (1701) 3 Salk 239, 91 E.R. 800, Mod. 7, E.R. 485 .....                               | 114                                           |
| Doige's Case (1442) Y.B. Trin. 20 Hen. 6, f. 34, pl. 4 .....                                         | 430                                           |
| Douglas v Patrick (1790) 3 T.R. 683, 100 E.R. 802 (KB) .....                                         | 27, 28                                        |
| Edgar v Chut (1663) 1 Keble 592, 83 E.R. 1130 .....                                                  | 447                                           |
| Edgcomb v Dee (1670) Vaugh. 89, 124 E.R. 984 .....                                                   | 440                                           |
| Emly v Lye (1812) 15 East. 7, 104 E.R. 746 .....                                                     | 480                                           |
| Emperor of Austria v Day and Kossuth (1861) 3 De G.F. & J. 217,<br>45 E.R. 861 (Ch. App.) .....      | 490                                           |
| In the Matter of Farley <i>ex parte</i> Danks (1852) 2 De G. M. & G. 936,<br>42 E.R. 1138 (Ch) ..... | 27                                            |
| Farquharson v Pearl Assurance Co Ltd [1937] 3 All ER 124 (KB) .....                                  | 27                                            |
| Faulkner v Lowe (1848) 2 Ex. 595, 154 E.R. 628 .....                                                 | 25                                            |
| Fenn v Harrison (1790) 3 T.R. 757, 100 E.R. 842 .....                                                | 480                                           |
| Finch v Brook (1834) 1 Bing. (N.C.) 253, 131 E.R. 1114 (CP) .....                                    | 27                                            |
| Fitzroy v Cave [1905] 2 KB 364 .....                                                                 | 50, 425, 530                                  |
| Foley v Hill (1848) 2 HLC 28, 9 E.R. 1002 (HL) .....                                                 | 43, 50, 351, 454,<br>558, 559, 598, 599       |
| Ford v Hopkins (1700) 1 Salk 283, 91 E.R. 250 .....                                                  | 556, 557, 559, 560                            |
| Foster v Mackinnon (1869) 20 L.T. 887 .....                                                          | 564                                           |
| Giles v Hartis (1698) 1 Ld. Raym. 254, 91 E.R. 1066 (KB) .....                                       | 27                                            |
| Gillett v Bank of England (1889) 6 T.L.R. 9 (QBD) .....                                              | 510                                           |
| Goodwin v Robarts (1875) LR 10 Ex. 337, <i>aff'd</i> (1875–76) LR 1 AC 476<br>(HL) .....             | 402, 530                                      |
| Gorringe v Irwell India Rubber and Gutta Percha Works (1886) 34<br>Ch.D 128 .....                    | 425                                           |
| Grant v Vaughan (1764) 3 Burr. 1516, 97 E.R. 957 .....                                               | 545, 546, 547, 554                            |
| Greenville v Slaninq (1616) .....                                                                    | 438                                           |
| Greenwood v Martins Bank Ltd [1932] 1 KB 371, <i>aff'd</i> [1933]<br>AC 51 .....                     | 618, 619                                      |
| Grelle v Lambert (1510–13), <i>reprinted</i> (1929) 46 Selden Soc. 2 .....                           | 459, 568, 569                                 |
| Griffin v Weatherby (1868) LR 3, QB 753 .....                                                        | 463                                           |

Guardians of the Poor of the Lichfield Union, *The v Greene* (1857)

|                                                                                                                                          |                             |
|------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------|
| 26 L.J.R. (N.S.) Exch. 140 .....                                                                                                         | 22, 489                     |
| <i>Hall v Fuller</i> (1825) (1825) 5 B. & C. 750; 108 E.R. 279 .....                                                                     | 618                         |
| <i>Hallett's Estate, Re</i> (1880) 13 Ch.D 696 (CA) .....                                                                                | 561                         |
| <i>Haly v Lane</i> (1741) 2 Atk. 181, 26 E.R. 513 .....                                                                                  | 575                         |
| <i>Harris v De Bervoir</i> (1624) Cro. Jac. 687, 79 E.R. 596 .....                                                                       | 438, 439, 454               |
| <i>Harry v Perrit</i> (1711) 1 Salk. 133, 91 E.R. 126 .....                                                                              | 537                         |
| <i>Hartop v Hoare</i> (1743) 3 Atk. 44, 26 E.R. 828 .....                                                                                | 557, 559                    |
| <i>Hastynge v Beverley</i> (1378–79) Y.B. 2 Rich. II .....                                                                               | 435, 440                    |
| <i>Higgs v Holiday</i> (1599) Cro. Eliz. 746, 78 E.R. 978, <i>rvs'g</i> <i>Holiday v Hicks</i><br>(1598) Cro Eliz 661, 78 E.R. 900 ..... | 350, 558, 559               |
| <i>Hill &amp; Al. v Lewis</i> , 91 E.R. 124 (1709) 1 Salk. 132 91 E.R.<br>124 (KB) .....                                                 | 458, 478, 534, 631          |
| <i>Hinton's Case</i> (1682) 2 Show. KB 235, 89 E.R. 911 .....                                                                            | 453, 544, 545, 554          |
| <i>Hodges v Steward</i> (1692) 1 Salk. 125, 91 E.R. 117 .....                                                                            | 453, 531, 532, 544          |
| <i>Holiday v Hicks</i> (1597) Cro Eliz 638, 78 E.R. 878 .....                                                                            | 350                         |
| <i>Holiday v Hicks</i> (1598) Cro Eliz 661, 78 E.R. 900 .....                                                                            | 350                         |
| <i>Hong Kong and Shanghai Banking Corp v Lo Lee Shi</i> [1928]<br>AC 181 (PC) .....                                                      | 510                         |
| <i>Hopkins v Geary</i> (1702) Hil.1 Ann. B.R. Guildhall .....                                                                            | 478, 631                    |
| <i>Hopkinson v Forster</i> (1874) LR 19 Eq. 74 .....                                                                                     | 548                         |
| <i>Hoppman v Richard of Welborne</i> (1302), <i>reprinted</i> (1908) 23 Selden<br>Soc. 86 .....                                          | 542                         |
| <i>Horton v Cogg</i> (1689) 3 Lev. 299, 83 E.R. 698 .....                                                                                | 544                         |
| <i>Hussey v Jacob</i> (1696) 1 Comyns. 4, 92 E.R. 929 .....                                                                              | 575                         |
| <i>Imeson, ex parte</i> (1815) 2 Rose's Bkcy Cas. 225 .....                                                                              | 489                         |
| <i>Innkeeper's Case, The</i> (1369) Y.B. Easter 42 Ed. 3, f.11, pl. 13 .....                                                             | 450                         |
| <i>Isaack v Clark</i> (1615) 2 Bust. 306, 80 E.R. 1143 .....                                                                             | 558, 559                    |
| <i>Isherwood v Whitmore</i> (1842) 10 M. & W. 756, 152 E.R. 677 (Ex) .....                                                               | 28                          |
| <i>Israel v Douglas</i> (1789) 1 H. Bl. 239, 126 E.R. 139 .....                                                                          | 438, 454, 462, 463          |
| <i>James Lamont &amp; Co Ltd v Hyland Ltd</i> (No 2) [1950] 1 All ER 929 (CA) .....                                                      | 579                         |
| <i>JH Rayner v Hambro's Bank</i> [1943] KB 37 .....                                                                                      | 290                         |
| <i>Joachimson v Swiss Bank Corp</i> [1921] 3 KB 110 (CA) .....                                                                           | 454, 463, 599               |
| <i>Jones v Ryde</i> (1814) 3 Taunt 488, 128 E.R. 779 (KB) .....                                                                          | 30                          |
| <i>Josceline v Lassere</i> (1714) Fortescue 281, 92 E.R. 853 .....                                                                       | 535                         |
| <i>Keene v Beard</i> (1860) 8 C.B. (N.S.) 372, 141 E.R. 1210 .....                                                                       | 548, 549                    |
| <i>Lancashire v Killingworth</i> (1700) 1 Ld. Raym. 686, 91 E.R. 1357 (KB) .....                                                         | 27                          |
| <i>Leatherdale v Sweepstone</i> (1828) 3 Car. & P. 342, 172 E.R. 448 (NP) .....                                                          | 27                          |
| <i>Libyan Arab Foreign Bank v Bankers Trust Co</i> [1989] 3 All ER 252;<br>[1988] 1 Lloyd's Rep. 259 (QB, Com. Ct) .....                 | 40, 465, 523, 525, 599, 608 |
| <i>Lickbarrow v Mason</i> (1787) 2 T.R. 63, 100 E.R. 35 .....                                                                            | 576, 577                    |
| <i>Liversidge v Broadbent</i> (1859) 4 H. & N. 603, 157 E.R. 978 .....                                                                   | 461, 463                    |
| <i>London Joint Stock Bank v Macmillan</i> [1918] AC 777 (HL) .....                                                                      | 612, 619                    |
| <i>London Joint Stock Bank v Simmons</i> [1892] AC 201 .....                                                                             | 564                         |

|                                                                                                                                                                                         |                                                                             |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------|
| Luffenham v Abbot of Westminster (1313) Y.B. Hil. 6 Ed. II,<br><i>reprinted</i> (1926) 43 Selden Soc. 65 .....                                                                          | 426, 558                                                                    |
| Mangles v Dixon (1852) 3 HLC. 702, 10 E.R. 278 .....                                                                                                                                    | 425                                                                         |
| Mardorf Peach & Co v Attica Sea Carriers Corp of Liberia ( <i>The Laconia</i> )<br>[1976] 2 All ER 249 ( <i>appeal taken from QBD</i> ), <i>rev'd</i> [1977] 1 All ER 545<br>(HL) ..... | 59, 524, 622                                                                |
| Martin v Boure (1602) Cro. Jac. 6, 79 E.R. 6 .....                                                                                                                                      | 447                                                                         |
| Master v Miller (1791) 4 T.R. 320, 100 E.R. 1042 .....                                                                                                                                  | 425                                                                         |
| Mead v Young (1790) 4 T.R. 28, 100 E.R. 876 .....                                                                                                                                       | 567                                                                         |
| Mercedes-Benz Finance Ltd v Clydesdale Bank plc 1996 SCLR 1005<br>(Court of Session, Outer House) .....                                                                                 | 608, 612                                                                    |
| Miliangos v George Frank (Textile) Ltd [1976] AC 443 (HL) .....                                                                                                                         | 26                                                                          |
| Miller v Race (1758) 1 Burr. 452, 97 E.R. 398 (KB) .....                                                                                                                                | 92, 109, 111, 460, 488,<br>489, 518, 546, 555, 557, 558, 560, 566, 567, 576 |
| Morris v Lee (1786) B.R.H. 26 Geo. 3, 1 Comyns. 43, 92 E.R. 950 .....                                                                                                                   | 576                                                                         |
| Morse v Slue (1671) 1 Ventris 190, 86 E.R. 129 .....                                                                                                                                    | 450                                                                         |
| Moss v Hancock [1899] 2 QB 111 .....                                                                                                                                                    | 18, 481, 524                                                                |
| National Westminster Bank v Barclays Bank International [1975]<br>QB 654 .....                                                                                                          | 613, 618                                                                    |
| New Brunswick Railway Co v British and French Trust Corp Ltd [1939]<br>AC 1 (HL) .....                                                                                                  | 27                                                                          |
| Nicholson v Sedgwick (1698) 1 Ld. Raym. 180, 91 E.R. 1016 .....                                                                                                                         | 544, 545                                                                    |
| Nova (Jersey) Knit Ltd v Kammgarn Spinnerei GmbH [1977] 1 WLR<br>713 (HL) .....                                                                                                         | 573, 579                                                                    |
| Oaste v Taylor (1612) Cro. Jac. 306, 79 E.R. 262 .....                                                                                                                                  | 447, 458, 535                                                               |
| Peacock v Rhodes (1781) 2 Doug. 633, 99 E.R. 402 .....                                                                                                                                  | 576                                                                         |
| Pearson v Garrett (1693) 4 Mod. 242, 87 E.R. 371 .....                                                                                                                                  | 535                                                                         |
| Petit v Benson (1697) Comb. 452, 90 E.R. 586 .....                                                                                                                                      | 574                                                                         |
| Pirton v Tumby (1315) Y.B. 8 Ed. II .....                                                                                                                                               | 434                                                                         |
| Pope v Leiger (1694) Mod. 1, 87 E.R. 481 .....                                                                                                                                          | 114                                                                         |
| Pott v Clegg (1847) 16 M. & W. 321, 153 E.R. 1212 .....                                                                                                                                 | 454, 598                                                                    |
| Puget de Bras v Forbes (1792) 1 Esp. 117, 170 E.R. 298 .....                                                                                                                            | 577                                                                         |
| R v Preddy [1996] AC 815 (HL) .....                                                                                                                                                     | 525, 608                                                                    |
| R v Williams [1942] AC 541 (PC) .....                                                                                                                                                   | 535                                                                         |
| Randolph v Abbot of Hailes (1313–14) Eyre of Kent, 6 & 7 Edw. II<br>(1912), 27 Selden Soc. 32 .....                                                                                     | 444                                                                         |
| Rann v Hughes (1778) 7 T.R. 350, 101 E.R. 1014 .....                                                                                                                                    | 538, 572                                                                    |
| Raphael v Bank of England (1855) 17 C.B. 161, 139 E.R. 1030 .....                                                                                                                       | 510                                                                         |
| RE Jones Ltd v Waring and Gillow Ltd [1926] AC 670 .....                                                                                                                                | 460, 580                                                                    |
| Robinson v Cook (1815) 6 Taunt. 336, 128 E.R. 1064 (CP) .....                                                                                                                           | 27                                                                          |
| Robsert v Andrews (1580) Cro. Eliz. 82, 78 E.R. 341 .....                                                                                                                               | 438                                                                         |
| Royal Products v Midland Bank (1981) 2 Lloyd's Rep 194 (QBD) ....                                                                                                                       | 58, 619, 620                                                                |
| Salman v Barkyng (1422) Y.B. 1 Hen. VI, <i>reprinted</i> (1933) 50 Selden<br>Soc. 114 .....                                                                                             | 570, 630                                                                    |

|                                                                                                 |                                            |
|-------------------------------------------------------------------------------------------------|--------------------------------------------|
| Scholfield v Earl of Londesborough [1896] AC 514 (HL) .....                                     | 618                                        |
| Scott v Surman (1742) Willes 400, 125 E.R. 1235 (CP) .....                                      | 53, 351, 559                               |
| Selangor United Rubber Estates v Cradock (No 3) [1968] 1 WLR 1555<br>(Ch.D) .....               | 612                                        |
| Serle v Norton (1841) 2 M. & Rob. 401, 174 E.R. 331 .....                                       | 548                                        |
| Shand v Du Buisson (1874) LR 18 Eq. 283 .....                                                   | 461                                        |
| Shaw v Norwood (1600) Moore KB 667, 72 E.R. 827 .....                                           | 437                                        |
| Shelden v Hentley (1681) 2 Show. KB 160, 89 E.R. 860 .....                                      | 544                                        |
| Simmons v Swift (1826) (1826) 5 B. & C. 857, 108 E.R. 319 (KB) .....                            | 37                                         |
| Sinclair v Brougham [1914] AC 398 (HL) .....                                                    | 559                                        |
| Sir George Walgraces Case (1606) Noy. 12, 74 E.R. 983 .....                                     | 428, 558                                   |
| Slade's Case (1602) 4 Coke Rep. 91a, 92b, 76 E.R. 1072 .....                                    | 447, 454                                   |
| Southcote v Bennet (1601) Croke, Eliz. 815, 78 E.R. 1041; 4 Co. Rep.<br>83b, 76 E.R. 1061 ..... | 429                                        |
| Sproat v Matthews (1786) 1 T.R. 182, 99 E.R. 1041 .....                                         | 574                                        |
| Starke v Cheeseman (1700) 1 Ld. Raym. 538, 91 E.R. 1259 .....                                   | 452, 453, 569                              |
| Steel Wing Co, In Re [1921] 1 Ch. 349 .....                                                     | 465                                        |
| Stocks v Dobson (1853) 4 De G.M. & G. 11, 43 E.R. 411 (Ch) .....                                | 50, 425                                    |
| Sucklinge v Coney (1598) (1598) Noy 74, 74 E.R. 1041 (KB) .....                                 | 27                                         |
| Suffell v Bank of England (1882) 9 QBD 555 .....                                                | 510                                        |
| Surgeon's Case, The (1375) YB Hil. 48 Ed. 3, f.6, pl. 11 .....                                  | 446                                        |
| Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd [1986] AC 80 (PC) ...                        | 619                                        |
| Tailby v The Official Receiver (1888) 13 App. Cas. 523 (HL) .....                               | 50, 425, 541                               |
| Tassell and Lee v Lewis (1701) 1 Ld. Raym. 743, 91 E.R. 1397<br>(KB) .....                      | 22, 451, 478, 525, 533, 537, 538, 539, 631 |
| Taylor v Plumer (1815) 3 M. & S. 562, 105 E.R. 721 (KB) .....                                   | 53, 561, 562                               |
| Thames Sack and Bag Co Ltd v Knowles & Co Ltd (1918) 88 LJKB<br>585 (KB), 119 LT 287 .....      | 32                                         |
| Thomas v Evans (1808) 10 East 101, 103 E.R. 714 .....                                           | 27                                         |
| Thomson v Clydesdale Bank Ltd [1893] AC 282 (HL) .....                                          | 54                                         |
| Tinckler v Prentice (1812) 4 Taunt. 549, 128 E.R. 445 (CP) .....                                | 28                                         |
| Tourville v Naish (1734) 3 P. Wms. 307, 24 E.R. 1077 .....                                      | 572                                        |
| Treseder-Griffin v Co-operative Insurance Society Ltd [1956] 2 QB 127<br>(CA) .....             | 89                                         |
| Trueman v Hurst (1785) 1 T.R. 40, 99 E.R. 960 .....                                             | 576                                        |
| Turberville v Stamp (1697) 3 Ld. Raymond 375 .....                                              | 450                                        |
| Vyner v Clipsham .....                                                                          | 482                                        |
| Wade's Case (1601) 5 Co. Rep. 114a, 77 E.R. 232 (CP) .....                                      | 27, 28, 29, 30, 31, 113                    |
| Wait, In Re [1927] 1 Ch 606 (CA) .....                                                          | 32                                         |
| Wait v Barker (1848) 2 Ex. 1, 154 E.R. 380 .....                                                | 32                                         |
| Ward v Evans (1702) 2 Ld. Raym. 928, 92 E.R. 120 (KB) ...                                       | 22, 458, 478, 479, 631                     |
| Warwick v Nairn (1855) 10 Ex. 762, 156 E.R. 648 .....                                           | 579                                        |
| Wharton v Walker (1825) 4 B. & C. 163, 107 E.R. 1020 .....                                      | 463                                        |
| Whitecomb v Jacob (1711) 1 Salk 160, 91 E.R. 149 .....                                          | 351                                        |

|                                                                                                                          |              |
|--------------------------------------------------------------------------------------------------------------------------|--------------|
| Whorewood v Shaw (1602) Yelv. 25, 80 E.R. 18 .....                                                                       | 438, 439     |
| William Brandt's Sons & Co v Dunlop Rubber Co Ltd [1905] AC 454 (HL) ...                                                 | 50           |
| Williams v Everett (1811) 14 East 582, 104 E.R. 725 .....                                                                | 462          |
| Williams v Field (1694) 3 Salk. 68, 91 E.R. 696 .....                                                                    | 451, 531     |
| Williams v Williams (1693) Carth. 269, 90 E.R. 759 .....                                                                 | 534          |
| WJ Alan & Co Ltd v El Nasr Export & Import Co [1972] 2 All ER 127<br>(CA), [1972] 2 QB 189 .....                         | 55, 185, 626 |
| Woodhouse AC Israel Cocoa Ltd SA v Nigerian Produce Marketing Co Ltd<br>[1971] 2 QB 23, <i>aff'd</i> [1972] AC 741 ..... | 26, 381      |
| Woodward v Rowe (1666) 2 Keb. 105 and 132; 84 E.R. 67 and 84 .....                                                       | 451          |
| Wright v Reed (1790) 3 T.R. 554, 100 E.R. 729 (KB) .....                                                                 | 489          |
| Young v Grote (1827) (1827) 4 Bing. 253; 130 E.R. 764 .....                                                              | 618, 619     |

#### UNITED STATES OF AMERICA

|                                                                                      |                    |
|--------------------------------------------------------------------------------------|--------------------|
| Atwood v Cornwall (1873) 28 Mich. 336 (Mich. SC) .....                               | 30, 31             |
| Bank of US v Bank of Georgia (1825) 10 Wheat 333, 23 U.S.R. 333<br>(US SC) .....     | 31                 |
| Corbit v Bank of Smyrna, 2 Harr. 235 (Del. 1837) .....                               | 480, 632           |
| Curcier v Pennock (1826) 14 Serg. & R. (SC, Pa.) 51 .....                            | 30, 31, 32         |
| Delbrueck v Manufacturers Hanover Trust Co, 609 F.2d 1047 (2nd Cir.<br>1979) .....   | 425, 465, 607, 608 |
| Hall v Stevens, 116 N.Y. 201, 22 N.E. 374 (NY SC, 1889) .....                        | 480, 632           |
| Hargrave v Dusenbury (1823) 9 N.C. 326 (SC, NC) .....                                | 30                 |
| Harris Trust and Savings Bank v McCray, 316 N.E.2d 209 (Ill. App.<br>Ct. 1974) ..... | 628                |
| Kenny v First National Bank of Albany (1867) 50 Barb. 112 (SC, NY) .....             | 31                 |
| Lowrey v Murrell, 2 Port. 280 (Ala., 1835) .....                                     | 480, 632           |
| Mudd v Reeves (1883) 2 H. & J. 368 (SC, Md.) .....                                   | 31                 |
| O'Brien v Grant (1895) 146 N.Y. 163 .....                                            | 496                |
| Ontario Bank v Lightbody, 13 Wend. 101 (N.Y., 1834) .....                            | 480, 632           |
| Phelan v Dalson (1853) 14 Ark. 79 .....                                              | 30                 |
| Pitman v Walker (1922) 187 Cal. 667 (S.C.) .....                                     | 573                |
| Rasst v Morris (1919) 108 A. 787 (SC, Md.) .....                                     | 31                 |
| Raymond v Baar (1825) 13 Serg. & R. (SC, Pa.) 317 .....                              | 31                 |
| Scruggs v Gass, 16 Tenn. 175 (1835) .....                                            | 480, 632           |
| Simms v Clark (1849) 11 Ill. 137 (SC, Ill.) .....                                    | 31                 |
| Wingate v Neidlinger (1875) 50 Ind. 520 (SC, Ind.) .....                             | 30, 31             |
| Young v Adams (1810) 6 Mass. 181, (SC, Mass.) .....                                  | 30, 31             |





# Table of Legislation

## AUSTRALIA

|                               |     |
|-------------------------------|-----|
| Cheques Act 1986 (Cth.) ..... | 606 |
|-------------------------------|-----|

## CANADA

|                                                                                                                                                                                                                                                     |          |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| Dominion Notes Act (R.S.C. 1906, c.27)                                                                                                                                                                                                              |          |
| s 2(a) .....                                                                                                                                                                                                                                        | 506      |
| s 4(2) .....                                                                                                                                                                                                                                        | 506      |
| Act to amend the Bank of Canada Act (S.C. 1953–54, c.33), s 8 .....                                                                                                                                                                                 | 510      |
| Act to revise the Bank Act, to amend the Quebec Savings Banks Act and<br>the Bank of Canada Act, to establish the Canadian Payments Association<br>and to amend other Acts in consequence thereof (S.C. 1980–81–82–83,<br>c.40), Pt III, s 49 ..... | 517      |
| Act to amend the Bank of Canada Act (S.C. 1966–67, c.88)                                                                                                                                                                                            |          |
| s 12 .....                                                                                                                                                                                                                                          | 510      |
| s 13 .....                                                                                                                                                                                                                                          | 509      |
| s. 20(1)(c) ...                                                                                                                                                                                                                                     | 510      |
| Bank Act (R.S.C. 1927, c.12), ss 61–74 .....                                                                                                                                                                                                        | 506      |
| Bank of Canada Act (S.C. 1934, c.43)                                                                                                                                                                                                                |          |
| s 24(1) .....                                                                                                                                                                                                                                       | 509      |
| s 25 .....                                                                                                                                                                                                                                          | 509      |
| s 41 .....                                                                                                                                                                                                                                          | 517      |
| Bank of Canada Act (R.S.C. 1952, c.13) .....                                                                                                                                                                                                        | 510      |
| s 21(1) .....                                                                                                                                                                                                                                       | 510, 516 |
| Bank of Canada Act (R.S.C. 1970, c. B-2), s 30 .....                                                                                                                                                                                                | 517      |
| Bank of Canada Act (R.S.C. 1985, c. B-2) .....                                                                                                                                                                                                      | 25, 510  |
| s 23 .....                                                                                                                                                                                                                                          | 510      |
| s 25(1) .....                                                                                                                                                                                                                                       | 516      |
| s 25(6) .....                                                                                                                                                                                                                                       | 510, 517 |
| s 34 .....                                                                                                                                                                                                                                          | 517      |
| Sch II .....                                                                                                                                                                                                                                        | 516      |
| Banks and Banking Law Revision Act (S.C. 1980–81–82–83, c.40), s 49 .....                                                                                                                                                                           | 510      |
| Bills of Exchange Act (R.S.C. 1970, c. B-5) .....                                                                                                                                                                                                   | 514, 515 |
| s 10 .....                                                                                                                                                                                                                                          | 514      |
| ss 156–157 .....                                                                                                                                                                                                                                    | 514      |

|                                                                       |                                      |
|-----------------------------------------------------------------------|--------------------------------------|
| s 176 .....                                                           | 514, 517                             |
| s 186(1) .....                                                        | 514                                  |
| Bills of Exchange Act (R.S.C. 1985, c. B-4) .....                     | 370, 509, 510,<br>514, 515, 530, 606 |
| s 9 .....                                                             | 514                                  |
| s 16(1) .....                                                         | 186                                  |
| s 94 .....                                                            | 185                                  |
| s 126 .....                                                           | 185                                  |
| s 129(a) .....                                                        | 185                                  |
| s 130 .....                                                           | 185                                  |
| ss 155–156 .....                                                      | 514                                  |
| s 165 .....                                                           | 185                                  |
| s 165(1) .....                                                        | 186                                  |
| s 176 .....                                                           | 509, 514, 517                        |
| Code Civil du Québec .....                                            | 600, 613, 614, 617, 618              |
| Art 1638 .....                                                        | 635                                  |
| Art 1643 .....                                                        | 635                                  |
| Arts 1667–1670 .....                                                  | 637                                  |
| Art 2130 .....                                                        | 613                                  |
| Art 2138 .....                                                        | 617                                  |
| Art 2140(1)–(2) .....                                                 | 617                                  |
| Art 2141 .....                                                        | 617                                  |
| Art 2142 .....                                                        | 618                                  |
| Arts 2149–2151 .....                                                  | 617                                  |
| Art 2154 .....                                                        | 614                                  |
| Currency Act (R.S.C. 1927, c.40) .....                                | 506                                  |
| Currency Act (R.S.C. 1985, c. C-52)                                   |                                      |
| s 7 .....                                                             | 25                                   |
| s 8 .....                                                             | 514                                  |
| s 8(1) .....                                                          | 25                                   |
| Currency, Mint and Exchange Fund Act 1952 (c.315)                     |                                      |
| s 7(1)(c) .....                                                       | 510                                  |
| s 7 .....                                                             | 514                                  |
| Dominion Notes Act (R.S.C. 1927, c.41) .....                          | 506                                  |
| s 2(b) .....                                                          | 506                                  |
| s 4 .....                                                             | 506                                  |
| s 4(3) .....                                                          | 506                                  |
| Financial Consumer Agency of Canada Act (S.C. 2001, c.9), s 202 ..... | 516                                  |
| Payments Act (R.S.C. 1985, c. C-21)                                   |                                      |
| s 2(1) .....                                                          | 605                                  |
| s 4(2)(a) .....                                                       | 605                                  |
| s 4(2)(c) .....                                                       | 605                                  |
| Personal Property Security Act (Ontario) (RSO 1990, c. P.10) .....    | 239                                  |
| s 1 .....                                                             | 54                                   |

|                                                               |     |
|---------------------------------------------------------------|-----|
| Royal Canadian Mint Act (RSC 1985, c R-9) .....               | 25  |
| Sale of Goods Act (Ontario) (R.S.O. 1990, c. S.1), s 21 ..... | 239 |

## EUROPEAN UNION

|                                                                                                                                                             |                              |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|
| EC Treaty                                                                                                                                                   |                              |
| Art 47(2) .....                                                                                                                                             | 589                          |
| Art 95(1) .....                                                                                                                                             | 589                          |
| ECB Protocol on the Statute of the European System of Central Banks<br>and of the European Central Bank, Art 2 [1992] O.J. C 191/68<br>(29 July 1992) ..... | 499                          |
| Directives                                                                                                                                                  |                              |
| Directive 83/349/EEC, Art 12(1).....                                                                                                                        | 595                          |
| Directive 97/5/EC .....                                                                                                                                     | 590                          |
| Directive 97/7/EC .....                                                                                                                                     | 590                          |
| Directive 2000/46/EC.....                                                                                                                                   | 591                          |
| Art 1(3) .....                                                                                                                                              | 592                          |
| Art 1(3)(a) .....                                                                                                                                           | 590                          |
| Art 1(3)(b) .....                                                                                                                                           | 594                          |
| Directive 2002/65/EC.....                                                                                                                                   | 590                          |
| Directive 2005/60/EC.....                                                                                                                                   | 590, 591                     |
| Directive 2006/48/EC (Banking) .....                                                                                                                        | 590, 591, 592                |
| Preamble, para 13.....                                                                                                                                      | 603                          |
| Art 4(1) .....                                                                                                                                              | 591, 603                     |
| Art 4(1)(a) .....                                                                                                                                           | 590                          |
| Art 5.....                                                                                                                                                  | 592                          |
| Annex 1, paras 4–5 .....                                                                                                                                    | 591                          |
| Directive 2007/64/EC (Payment Services).....                                                                                                                | 590, 591, 593, 596, 613, 622 |
| Preamble.....                                                                                                                                               | 592                          |
| para 11.....                                                                                                                                                | 592                          |
| para 14.....                                                                                                                                                | 592                          |
| para 19.....                                                                                                                                                | 594, 595                     |
| Title II .....                                                                                                                                              | 592                          |
| Chapter 1 .....                                                                                                                                             | 591, 592                     |
| Art 1(1) .....                                                                                                                                              | 590                          |
| Art 2(1) .....                                                                                                                                              | 590, 593                     |
| Art 3 .....                                                                                                                                                 | 594, 595                     |
| Art 3(a) .....                                                                                                                                              | 594                          |
| Art 3(b).....                                                                                                                                               | 595                          |
| Art 3(e)–(f).....                                                                                                                                           | 595                          |
| Art 3(o).....                                                                                                                                               | 595                          |
| Art 3(1) .....                                                                                                                                              | 595                          |
| Art 4(3) .....                                                                                                                                              | 593                          |

|                                       |                        |
|---------------------------------------|------------------------|
| Art 4(4) .....                        | 592, 603               |
| Art 4(5) .....                        | 594                    |
| Art 4(7)–(10) .....                   | 590                    |
| Art 4(12) .....                       | 595                    |
| Art 4(13)–(16) .....                  | 594                    |
| Art 4(22) .....                       | 595                    |
| Art 4(23) .....                       | 594                    |
| Art 4(28) .....                       | 594                    |
| Art 4(30) .....                       | 595                    |
| Arts 5–8 .....                        | 593                    |
| Art 9 .....                           | 592, 593, 604          |
| Art 9(1)(a) .....                     | 604                    |
| Art 10 .....                          | 592, 593               |
| Art 10(5) .....                       | 592                    |
| Art 10(9) .....                       | 591                    |
| Arts 11–15 .....                      | 593                    |
| Art 16(2) .....                       | 592                    |
| Arts 17–24 .....                      | 593                    |
| Art 26 .....                          | 590, 592               |
| Art 75(1) .....                       | 621                    |
| Annex .....                           | 40, 591, 593, 594, 595 |
| Directive 2009/110/EC (E-money) ..... | 591, 603               |
| Art 2(1)–(2) .....                    | 603                    |
| Art 6 .....                           | 591                    |
| Art 6(1)(a)–(b) .....                 | 591                    |
| Art 7 .....                           | 604                    |
| Art 11 .....                          | 603                    |

## FRANCE

|                      |               |
|----------------------|---------------|
| Civil Code .....     | 613, 614, 634 |
| Art 1275 .....       | 636           |
| Art 1276 .....       | 637           |
| Arts 1278–1279 ..... | 637           |
| Art 1692 .....       | 635           |
| Arts 1694–1695 ..... | 636           |
| Art 1984 .....       | 613           |
| Arts 1991–1993 ..... | 614           |
| Art 1994 .....       | 615           |
| Arts 1999–2000 ..... | 614           |
| Art 2138 .....       | 614           |
| Code of Commerce     |               |
| Art L 511-7 .....    | 461           |

|                      |     |
|----------------------|-----|
| Art L 511-7(3) ..... | 417 |
| Art L 511-19.....    | 417 |

## GERMANY

|                          |                         |
|--------------------------|-------------------------|
| Civil Code (BGB) .....   | 600, 601, 609, 613, 614 |
| Section 241.....         | 615                     |
| Section 276.....         | 614, 615                |
| Section 278.....         | 615                     |
| Section 362(1) .....     | 625                     |
| Section 364(1)–(2) ..... | 625                     |
| Section 401.....         | 635                     |
| Section 404.....         | 635                     |
| Sections 607–610 .....   | 602                     |
| Section 662.....         | 613                     |
| Section 664.....         | 615                     |
| Sections 666–669 .....   | 615                     |
| Section 670.....         | 614, 615                |
| Section 675.....         | 613                     |
| Section 700.....         | 601                     |
| Section 783.....         | 609                     |
| Section 784.....         | 609                     |
| Section 784(1)–(2) ..... | 610                     |
| Sections 785–786 .....   | 609, 610                |
| Section 787.....         | 609                     |
| Section 787(1)–(2) ..... | 611                     |
| Sections 788–789 .....   | 609, 610                |
| Sections 790–792 .....   | 609, 611                |

## ITALY

|                      |               |
|----------------------|---------------|
| Civil Code .....     | 600, 613, 614 |
| Art 1198.....        | 635           |
| Art 1263.....        | 635           |
| Arts 1268–1271 ..... | 637           |
| Art 1703.....        | 613           |
| Art 1710.....        | 614           |
| Art 1710(1)–(2)..... | 616           |
| Art 1713.....        | 616           |
| Art 1717(1)–(3)..... | 616           |
| Art 1719.....        | 616           |
| Art 1720.....        | 614, 616      |

|                      |          |
|----------------------|----------|
| Art 1782.....        | 602      |
| Arts 1813–1822 ..... | 602      |
| Arts 1834–1855 ..... | 602      |
| Art 1856.....        | 602, 616 |
| Art 1856(1).....     | 612      |
| Art 1856(2).....     | 616      |
| Arts 1857–1860 ..... | 602      |

## JAPAN

|                      |                         |
|----------------------|-------------------------|
| Civil Code .....     | 600, 601, 613, 614, 617 |
| Arts 99–104.....     | 617                     |
| Art 105 .....        | 617                     |
| Art 105(1)–(2) ..... | 617                     |
| Art 106 .....        | 617                     |
| Art 107 .....        | 617                     |
| Art 107(2) .....     | 617                     |
| Arts 108–118.....    | 617                     |
| Arts 587–592.....    | 602                     |
| Art 643 .....        | 613                     |
| Art 644 .....        | 614, 616                |
| Arts 645–647.....    | 616                     |
| Arts 648–649.....    | 617                     |
| Art 650 .....        | 614, 617                |
| Art 656 .....        | 613                     |
| Art 666 .....        | 601                     |

## OTTOMAN EMPIRE

|                           |                                   |
|---------------------------|-----------------------------------|
| Mejelle (Civil Code)..... | 256, 257, 268, 269, 270, 273, 275 |
| Book IV .....             | 269                               |
| Art 612 .....             | 270                               |
| Art 631 .....             | 270                               |
| Arts 673–677.....         | 269                               |
| Art 678 .....             | 265, 269, 273                     |
| Art 679 .....             | 269, 273                          |
| Art 680 .....             | 269, 270, 271                     |
| Art 681 .....             | 269, 270                          |
| Art 682 .....             | 269, 270, 271                     |
| Art 683 .....             | 269, 270                          |
| Arts 684–687.....         | 269                               |
| Art 688 .....             | 269, 270                          |

|                    |                    |
|--------------------|--------------------|
| Art 689 .....      | 269                |
| Art 690 .....      | 269, 272, 275      |
| Art 691 .....      | 269, 274, 275      |
| Art 692 .....      | 269                |
| Art 693 .....      | 268, 269, 275      |
| Art 694 .....      | 269, 275, 276      |
| Art 695 .....      | 269, 276           |
| Art 696 .....      | 269, 274, 276      |
| Art 697 .....      | 269, 272           |
| Arts 698–699 ..... | 269, 273, 274, 275 |
| Art 700 .....      | 269, 273, 274      |

## ROMAN EMPIRE

|                                                      |                    |
|------------------------------------------------------|--------------------|
| Diocletian's Price Edict (301 CE) .....              | 89                 |
| Gaius' Institutes                                    |                    |
| Book II, Section 95 .....                            | 205                |
| Book III                                             |                    |
| Sections 128–30 .....                                | 225                |
| Section 134 .....                                    | 129, 231           |
| Book IV                                              |                    |
| Sections 38–39 .....                                 | 235                |
| Section 61–68 .....                                  | 207                |
| Sections 83–84 .....                                 | 224, 234           |
| Section 86 .....                                     | 234                |
| Section 87 .....                                     | 224                |
| Section 126a .....                                   | 220                |
| Justinian's Code, Book IV, Title XVIII, para 2 ..... | 229, 230, 361      |
| Justinian's Digest .....                             | 111, 112, 113, 193 |
| 2.14.7.12 .....                                      | 230                |
| 2.14.47.1 .....                                      | 231                |
| 5.3.18 .....                                         | 199, 217           |
| 12.1.2 .....                                         | 111                |
| 12.1.2.1 .....                                       | 111                |
| 12.1.2.2 .....                                       | 111                |
| 12.1.2.4 .....                                       | 111                |
| 12.1.3 .....                                         | 111                |
| 12.1.8 .....                                         | 111                |
| 13.7.24.1 .....                                      | 112                |
| 16.3.7.2 .....                                       | 198                |
| 18.1.1 .....                                         | 111                |
| 19.2.31 .....                                        | 199                |
| 42.5.24.2 .....                                      | 198                |

44.4.5.4 .....220

Justinian’s Institutes .....193

Book III

    Title XIV .....236

    Title XV .....230

    Title XXI ..... 225, 226, 229

    Title XXVI .....210

    Title XXIX ..... 219, 225, 227, 232, 235, 236

        para 3a .....230

Book IV

    Title VI .....207

        para 30 .....206

        para 39 .....206

    Title XVI .....212

SWITZERLAND

Code of Obligations .....241, 600, 601, 609, 613, 614

    Art 68 .....615

    Art 101(1) .....615

    Art 164 .....635

    Arts 169–170 .....635

    Arts 175–180 .....636

    Arts 312–318 .....601

    Art 321a .....615

    Art 321a(1) .....614

    Art 321e .....615

    Art 321e(1) .....614

    Art 394(1) .....613, 615

    Art 398 .....614

    Art 398(1)–(3) .....615

    Art 399 .....616

    Arts 400–401 .....615

    Art 402(2) .....614, 616

    Art 466 .....609, 635

    Art 467 .....609

    Art 467(1)–(3) .....610

    Art 468 .....609

    Art 468(1) .....610

    Art 468(2)–(3) .....611

    Art 469 .....609, 610

    Art 470 .....609

    Art 470(1)–(3) .....611



|                    |     |
|--------------------|-----|
| Art 471 .....      | 609 |
| Art 471(1) .....   | 611 |
| Arts 472–491 ..... | 601 |
| Art 965 .....      | 583 |

## TUNISIA

### Code Civil et Commercial Tunisien

|               |               |
|---------------|---------------|
| Art 1964..... | 299, 300, 344 |
| Art 2011..... | 285           |

## UNITED KINGDOM

|                                                                |                                                                                           |
|----------------------------------------------------------------|-------------------------------------------------------------------------------------------|
| Bank Charter Act 1844 (7 & 8 Vict., c.32) .....                | 489                                                                                       |
| ss 1–3 .....                                                   | 491                                                                                       |
| Bank of England Act 1694 (5 & 6 Will & Mar, c.20), s XIX ..... | 21                                                                                        |
| Bank of England Act 1708 (7 Ann. c.30), s 66.....              | 489                                                                                       |
| Bank of England Act 1833 (3 & 4 Will. IV, c.98) .....          | 491                                                                                       |
| s 6.....                                                       | 22, 489                                                                                   |
| Bank of England Act 1946 (9 & 10 Geo. VI, c.27) .....          | 505                                                                                       |
| Bank Notes (Scotland) Act 1845 (8 & 9 Vict., c.38) .....       | 490                                                                                       |
| s 5.....                                                       | 490                                                                                       |
| Bills of Exchange Act 1882 (45 & 46 Vict., c.61).....          | 283, 370, 508, 509, 510,<br>511, 518, 529, 536, 537, 541,<br>542, 548, 552, 580, 583, 606 |
| s 2.....                                                       | 377, 387, 542                                                                             |
| s 3.....                                                       | 553                                                                                       |
| s 3(1).....                                                    | 279, 290, 370, 533, 569, 606                                                              |
| s 3(3)(b) .....                                                | 535                                                                                       |
| s 8(2).....                                                    | 319                                                                                       |
| s 8(3).....                                                    | 566, 576                                                                                  |
| s 16(1) .....                                                  | 531                                                                                       |
| s 17 .....                                                     | 279, 460                                                                                  |
| s 17(2)(a) .....                                               | 452                                                                                       |
| s 19(2) .....                                                  | 574                                                                                       |
| s 19(2)(a) .....                                               | 574                                                                                       |
| s 21 .....                                                     | 628                                                                                       |
| s 23 .....                                                     | 279, 387, 452, 460, 607                                                                   |
| s 24 .....                                                     | 567                                                                                       |
| s 27(3) .....                                                  | 551                                                                                       |
| s 29(1) .....                                                  | 370, 529, 551, 552, 578                                                                   |
| s 29(1)(b).....                                                | 580                                                                                       |

|                                                                 |                                       |
|-----------------------------------------------------------------|---------------------------------------|
| s 30(1) .....                                                   | 535                                   |
| s 31 .....                                                      | 62, 370, 460, 529, 531, 551, 552, 606 |
| s 31(1) .....                                                   | 628                                   |
| s 31(3) .....                                                   | 529, 553, 628                         |
| s 33 .....                                                      | 529, 553                              |
| s 34(1) .....                                                   | 370, 566, 607                         |
| s 38(1) .....                                                   | 387, 460, 461, 542                    |
| s 38(2) .....                                                   | 370, 529, 551, 552, 578               |
| s 44(2)–(3) .....                                               | 574                                   |
| s 45 .....                                                      | 290                                   |
| s 52(4) .....                                                   | 290                                   |
| s 53 .....                                                      | 387, 461, 552                         |
| s 53(1) .....                                                   | 62, 460, 548, 607                     |
| s 53(1)(a)(1) .....                                             | 569                                   |
| s 53(2) .....                                                   | 607                                   |
| s 54 .....                                                      | 279                                   |
| s 54(1) .....                                                   | 417                                   |
| s 55 .....                                                      | 387, 552                              |
| s 55(1) .....                                                   | 552, 553                              |
| s 55(1)(a) .....                                                | 452                                   |
| s 55(2) .....                                                   | 531, 552                              |
| s 55(2)(a) .....                                                | 452                                   |
| s 59(1) .....                                                   | 542                                   |
| s 59(2)(a) .....                                                | 387                                   |
| ss 69–70 .....                                                  | 514                                   |
| s 73 .....                                                      | 62, 278, 547, 552, 578, 606           |
| s 74 .....                                                      | 548                                   |
| ss 75–75A .....                                                 | 607                                   |
| s 81A .....                                                     | 551                                   |
| s 83 .....                                                      | 509, 514                              |
| s 83(1) .....                                                   | 278, 508, 509, 533, 569               |
| s 89(1) .....                                                   | 514, 537, 541, 578                    |
| s 89(2) .....                                                   | 537, 541                              |
| s 97(2) .....                                                   | 514                                   |
| British North America Act 1867 (30 & 31 Vict., c.3) .....       | 475                                   |
| s 91(14) .....                                                  | 476                                   |
| s 91(15) .....                                                  | 475                                   |
| Cheques Act 1957 (5 & 6 Eliz. II, c.36) .....                   | 606                                   |
| s 2 .....                                                       | 551                                   |
| Coinage Act 1971 (1971, c.24) .....                             | 492                                   |
| Common Law Procedure Act 1854 (17 & 18 Vic., c.125), s 83 ..... | 572                                   |
| Constitution Act 1867 (30 & 31 Vict., c.3) .....                | 475                                   |
| Country Bankers Act 1826 (7 Geo. IV, c.46) .....                | 489                                   |
| Currency Act 1983 (1983, c.9) .....                             | 492                                   |

|                                                                                                  |                                      |
|--------------------------------------------------------------------------------------------------|--------------------------------------|
| Currency and Bank Notes Act 1914 (4 & 5 Geo. V, c.14) .....                                      | 490                                  |
| s 1(1).....                                                                                      | 490                                  |
| s 1(6).....                                                                                      | 490                                  |
| Currency and Bank Notes Act 1928 (18 & 19 Geo. V, c.13) .....                                    | 490                                  |
| s 1(1).....                                                                                      | 491                                  |
| s 2.....                                                                                         | 491                                  |
| s 2(1).....                                                                                      | 490                                  |
| s 3(1)–(2).....                                                                                  | 491                                  |
| s 8.....                                                                                         | 491                                  |
| Currency and Bank Notes Act 1954.....                                                            | 489                                  |
| s 1(2).....                                                                                      | 491                                  |
| s 1(3).....                                                                                      | 492                                  |
| Edict of Expulsion 1290 .....                                                                    | 470                                  |
| Exchange Equalisation Account Act 1979 (1979, c.30), Sch.....                                    | 491                                  |
| Factors Act 1889 (52 & 53 Vic., c.45)                                                            |                                      |
| s 2(1).....                                                                                      | 565                                  |
| ss 8–9 .....                                                                                     | 565                                  |
| Finance Act 1932 (22 & 23 Geo. V, c. 25), s 25(7).....                                           | 491                                  |
| Gaming Act 1664 (16 Car 2, c.7) .....                                                            | 575                                  |
| Gold and Silver Coin Act 1351 (25 Edw 3, c 13).....                                              | 113                                  |
| Gold Standard Act 1925 (15 & 16 Geo. V, c.29) .....                                              | 22, 491                              |
| Gold Standard (Amendment) Act 1931 (21 & 22 Geo. V, c.46) .....                                  | 22, 492                              |
| Law Reform (Miscellaneous Provisions) (Scotland) Act 1985<br>(1985, c.73, SIF 30), s 11(a) ..... | 607                                  |
| Promissory Notes Act 1704 (3 & 4 Ann., c.8).....                                                 | 452, 536, 537,<br>540, 541, 545, 546 |
| ss 1–2 .....                                                                                     | 536, 546                             |
| s 3.....                                                                                         | 536                                  |
| Sale of Goods Act 1893 (56 & 57 Vic., c.71)                                                      |                                      |
| s 21(1) .....                                                                                    | 566                                  |
| s 23 .....                                                                                       | 565                                  |
| s 25(1)–(2) .....                                                                                | 565                                  |
| Sale of Goods Act 1979, s 18, r 5(1) .....                                                       | 32                                   |
| Statute of Purveyors 1353 (27 Edw. 3, c1) .....                                                  | 113                                  |
| Supreme Court of Judicature Act (1873, 36 & 37 Vict., c.66) .....                                | 465                                  |
| s 25(6) .....                                                                                    | 50, 351                              |
| Ways and Means Act 1694 (5 & 6 Will. & Mar., c.20)                                               |                                      |
| s XIX.....                                                                                       | 485                                  |
| s XXIX .....                                                                                     | 487                                  |

# UNITED STATES OF AMERICA

|                                                                                                                                                                                |                                   |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|
| Act to protect the currency system of the United States, to provide for the better use of the monetary gold stock of the United States, and for other purposes 1931, s 6 ..... | 507                               |
| Coinage Act 1965 .....                                                                                                                                                         | 507                               |
| Consumer Credit Cost Disclosure Act 1968 (15 U.S.C.), Section 1631 .....                                                                                                       | 65                                |
| Electronic Funds Transfer Act 1978 (15 U.S.C.), Section 1693 .....                                                                                                             | 65                                |
| Fair Credit Billing Act, Section 170 .....                                                                                                                                     | 627                               |
| Federal Reserve Act, c.6, 38 Stat. 251, s 16(1) .....                                                                                                                          | 507                               |
| Regulation E 12 C.F.R. (1981)                                                                                                                                                  |                                   |
| Section 205 (1981) .....                                                                                                                                                       | 65                                |
| Section 205.3(b) .....                                                                                                                                                         | 65                                |
| Truth In Lending Act 1968 .....                                                                                                                                                | 65                                |
| Regulation Z                                                                                                                                                                   |                                   |
| s 226.2(a) (15) .....                                                                                                                                                          | 65                                |
| s 226.12 .....                                                                                                                                                                 | 65                                |
| Uniform Commercial Code .....                                                                                                                                                  | 480, 508, 510, 578, 580, 619, 633 |
| Art 1, Section 1-201(b)(21)(A) .....                                                                                                                                           | 387                               |
| Art 2, Section 2-325 .....                                                                                                                                                     | 55, 626                           |
| Art 3 .....                                                                                                                                                                    | 370, 387, 412, 508, 529, 567, 606 |
| Pt 5 .....                                                                                                                                                                     | 387                               |
| Section 3-102(a) .....                                                                                                                                                         | 508                               |
| Section 3-103(1) .....                                                                                                                                                         | 508                               |
| Section 3-103(a)(15) .....                                                                                                                                                     | 387, 412                          |
| Section 3-104 .....                                                                                                                                                            | 370, 480, 508, 606, 633           |
| Section 3-104(a) .....                                                                                                                                                         | 508, 509, 606                     |
| Section 3-104(e) .....                                                                                                                                                         | 508, 606                          |
| Section 3-104(f) .....                                                                                                                                                         | 62, 606                           |
| Section 3-104(i) .....                                                                                                                                                         | 628                               |
| Section 3-105(a) .....                                                                                                                                                         | 377                               |
| Section 3-201 .....                                                                                                                                                            | 62, 370, 606                      |
| Section 3-205 .....                                                                                                                                                            | 370, 607                          |
| Section 3-301(i) .....                                                                                                                                                         | 387                               |
| Section 3-302 .....                                                                                                                                                            | 370, 578, 580                     |
| Section 3-302(a)(2) .....                                                                                                                                                      | 580                               |
| Section 3-305 .....                                                                                                                                                            | 370                               |
| Section 3-305(a) .....                                                                                                                                                         | 578                               |
| Section 3-305(a)(1) .....                                                                                                                                                      | 578, 580                          |
| Section 3-305(a)(2)–(3) .....                                                                                                                                                  | 578                               |
| Section 3-305(b) .....                                                                                                                                                         | 578, 580                          |
| Section 3-306 .....                                                                                                                                                            | 370, 578                          |
| Section 3-310 .....                                                                                                                                                            | 388                               |
| Section 3-310(a) .....                                                                                                                                                         | 55, 63, 479, 626                  |

|                                              |                            |
|----------------------------------------------|----------------------------|
| Section 3-310(b).....                        | 570, 626                   |
| Section 3-401.....                           | 387, 607                   |
| Section 3-406.....                           | 619                        |
| Section 3-408.....                           | 387, 607                   |
| Section 3-413.....                           | 417                        |
| Section 3-414.....                           | 387                        |
| Section 3-414(c).....                        | 185                        |
| Section 3-415.....                           | 387                        |
| Art 4                                        |                            |
| Section 4-103.....                           | 612                        |
| Section 4-201(a).....                        | 612                        |
| Section 4-403.....                           | 607                        |
| Art 4A .....                                 | x, 608, 613, 620, 621, 622 |
| Section 4A-103(a)(1)(i).....                 | 186                        |
| Section 4A-104(a).....                       | 608                        |
| Sections 4A-202–4A-205 .....                 | 621                        |
| Section 4A-209 .....                         | 608, 620                   |
| Section 4A-209(b).....                       | 609                        |
| Section 4A-211 .....                         | 608                        |
| Section 4A-211(g).....                       | 608                        |
| Section 4A-212 .....                         | 608, 620, 621              |
| Sections 4A-301–4A-302 .....                 | 608, 620                   |
| Section 4A-303 .....                         | 608, 621                   |
| Section 4A-305 .....                         | 608, 621                   |
| Section 4A-305(d).....                       | 608, 621                   |
| Section 4A-402 .....                         | 621                        |
| Section 4A-402(c).....                       | 608, 620                   |
| Section 4A-402(e).....                       | 608, 621                   |
| Section 4A-505 .....                         | 621                        |
| Art 5, Section 5-108.....                    | 627                        |
| Art 9.....                                   | 239                        |
| Section 9-308.....                           | 268                        |
| Uniform Money Services Act 2000.....         | 591                        |
| Art 2.....                                   | 591                        |
| Uniform Negotiable Instruments Law 1896..... | 508                        |

## UNITED ARAB EMIRATES

|                       |     |
|-----------------------|-----|
| Civil Code 1985 ..... | 269 |
|-----------------------|-----|



# *International and Miscellaneous Legislation*

## INTERATIONAL

|                                                                                                                                   |                         |
|-----------------------------------------------------------------------------------------------------------------------------------|-------------------------|
| Convention Providing a Uniform Law for Bills of Exchange and Promissory<br>Notes (1930) <i>see</i> Geneva Bills Convention (1930) |                         |
| Convention Providing a Uniform Law for Cheques (1931) .....                                                                       | 552, 553                |
| Art 1 .....                                                                                                                       | 62                      |
| Art 3 .....                                                                                                                       | 160                     |
| Art 4 .....                                                                                                                       | 552                     |
| Art 12 .....                                                                                                                      | 552                     |
| Art 14 .....                                                                                                                      | 62, 551                 |
| Art 18 .....                                                                                                                      | 552                     |
| Art 19 .....                                                                                                                      | 566                     |
| Art 22 .....                                                                                                                      | 580                     |
| Art 32 .....                                                                                                                      | 607                     |
| Art 40 .....                                                                                                                      | 552                     |
| Annex 1 .....                                                                                                                     | 62                      |
| Geneva Bills Convention (1930) .....                                                                                              | 370, 507, 508, 552, 553 |
| Art 1 .....                                                                                                                       | 370, 606                |
| Arts 7–8 .....                                                                                                                    | 387, 607                |
| Art 9 .....                                                                                                                       | 387, 552                |
| Art 11 .....                                                                                                                      | 370, 551, 606           |
| Arts 12–13 .....                                                                                                                  | 370, 607                |
| Art 15 .....                                                                                                                      | 387, 552                |
| Art 16 .....                                                                                                                      | 370, 387, 566           |
| Art 17 .....                                                                                                                      | 370, 387, 580           |
| Arts 18–19 .....                                                                                                                  | 387                     |
| Art 21 .....                                                                                                                      | 387, 607                |
| Art 25 .....                                                                                                                      | 387, 607                |
| Art 28 .....                                                                                                                      | 387, 417, 607           |
| Art 34 .....                                                                                                                      | 552                     |
| Art 40 .....                                                                                                                      | 387                     |
| Art 43 .....                                                                                                                      | 387, 552                |
| Arts 44–45 .....                                                                                                                  | 387                     |
| Art 75(1) .....                                                                                                                   | 508, 551                |
| Art 75(2) .....                                                                                                                   | 509                     |
| Art 75(5) .....                                                                                                                   | 508                     |

|                                                                                                                                  |               |
|----------------------------------------------------------------------------------------------------------------------------------|---------------|
| Annex I.....                                                                                                                     | 507, 606      |
| ICC Uniform Customs and Practice for Documentary Credits (2007<br>Revision) see UCP 600                                          |               |
| International Numismatic Convention (Jerusalem, 1963) .....                                                                      | 119           |
| UCP 600                                                                                                                          |               |
| Art 2 .....                                                                                                                      | 186, 279      |
| Art 4 .....                                                                                                                      | 186, 627      |
| Art 5 .....                                                                                                                      | 186           |
| ULB see Geneva Bills Convention (1930)                                                                                           |               |
| ULC see Convention Providing a Uniform Law for Cheques (1931)                                                                    |               |
| UNCITRAL Bills Convention .....                                                                                                  | 370, 606      |
| Art 3(1) .....                                                                                                                   | 370, 606      |
| Art 5(f) .....                                                                                                                   | 387           |
| Art 13 .....                                                                                                                     | 370, 606, 607 |
| Art 14 .....                                                                                                                     | 370, 607      |
| Art 15 .....                                                                                                                     | 370, 387, 607 |
| Art 16 .....                                                                                                                     | 370, 607      |
| Art 27 .....                                                                                                                     | 387           |
| Arts 29–30 .....                                                                                                                 | 370           |
| Art 33 .....                                                                                                                     | 387, 607      |
| Art 37 .....                                                                                                                     | 387, 607      |
| Art 38 .....                                                                                                                     | 387           |
| Art 40 .....                                                                                                                     | 387, 417, 607 |
| Art 44 .....                                                                                                                     | 387           |
| Art 70 .....                                                                                                                     | 387           |
| Art 77 .....                                                                                                                     | 387           |
| UNCITRAL Convention on Independent Guarantees and Stand-by<br>Letters of Credit (1995), Art 3 .....                              | 627           |
| United Nations Convention on International Bills of Exchange and<br>International Promissory Notes see UNCITRAL Bills Convention |               |

#### MISCELLANEOUS

|                                   |     |
|-----------------------------------|-----|
| Hammurabi's Code (1727 BCE) ..... | 20  |
| ss 120–126 .....                  | 121 |
| Laws of Eshnunna, ss 36–37 .....  | 121 |





*In a quest for global Law Merchant:  
the emergence and development of  
basic concepts for a coherent transnational payment law*

*A study in Roman, Jewish, Islamic and Medieval laws of the origins,  
early evolution and impact on modern law of universally accepted  
principles and instruments relating to money, banking, funds transfers,  
payment, and the discharge of a debt by means of the creditor's  
agreement to look to a paymaster instructed by the debtor*

# Prologue

|                                |    |
|--------------------------------|----|
| 1. The Theme                   | 1  |
| 2. The Context                 | 2  |
| 3. Description                 | 6  |
| 4. Contribution to Scholarship | 10 |

## 1. THE THEME

THE BOOK IS a study on the legal history of the order to pay money, initiating a non-cash payment. Outlining the ongoing evolution throughout the ages of money and payment mechanisms, the study explores the legal nature of the payment order. The text examines its legal underpinning in light of contemporary institutions and payment mechanisms. The discussion is carried on in the context of socio-economic, technological and, to some extent, political and religious conditions. It covers a long period, from Antiquity up to the present.

The study focuses on the development of principles in Antiquity and the Middle Ages and their influence on modern law. The research is carried out across diverse legal systems and covers doctrines which have been at the intersection of laws governing bank deposits, obligations, the assignment of debts, and negotiable instruments. Over the years, such doctrines have responded to institutional, socio-economic, and technological changes. At the same time, there has been a common denominator that allowed for the evolution of a coherent body of law governing the discharge of a debt by means of a third party's obligation or debt. This body of law consists of universal principles, emerging in various locations and legal systems, sometimes in isolation. Usually, such principles have reinforced each other and operated in a manner that has transcended boundaries among legal and payment systems.

A principal thesis respecting the development of the law of payment orders is that of progression over time with each later system, knowingly or unknowingly, building on an earlier one. Refuted theories are that (i) the diversity of payment systems precludes or at least militates against the existence of a coherent payment law; and that (ii) the 'law merchant' is of mercantile creation and not the result of the application of general principles of law to a given situation. Rather, it is argued, in each legal system there has been a body of law applicable to payment mechanisms. The common origin and nature of the response to similar challenges in the various legal systems is the global 'law merchant' governing payment mechanisms.

## 2 *Prologue*

The book covers developments in Ancient Mesopotamia, Ancient Greece, Rome, Greco-Roman Egypt, Continental Europe and England; it traces the roots of the modern global payment system, and its laws and institutions, through those developments. Doctrine is examined in Jewish, Islamic, Roman, common and civil laws. The ultimate objective is to provide (i) an account of the evolution of payment law as a distinct and cohesive body of legal doctrine applicable to funds transfers and payments, as well as (ii) a reassessment of the meaning of 'law merchant' as a branch of law, focusing on both a common denominator for, and interaction among, various legal systems.

A general theme is the development of principles of law, in tandem with the evolution of banking, in response to changing circumstances. Particular attention is given to Roman, Islamic and Talmudic legal traditions and payment mechanisms. A specific contribution made by this book is the reassessment of the possible impact of those legal traditions on the law and practice of Medieval payment instruments, as forerunners of negotiable instruments and payment orders in England and under modern payment legislation worldwide. This reassessment is made without diminishing the role of English banking and English law in providing the foundations of the modern payment system and its governing legal principles. This investigation is designed to explore the roots of English contributions and assess them in the broader context in which they occurred.

The book is designed to provide for a formulation of universal concepts for a coherent transnational payment law. It focuses on the discharge of a debt by means of a third party's obligation or debt. It does not deal with the allocation of losses in the diverse payment systems. It certainly does not advocate for a uniform loss allocation scheme for the misuse of all payment systems.

## 2. THE CONTEXT

The payment order initiates a non-cash payment. Its operation and impact are to be understood in the broad context of the entire payment system, consisting of institutions and mechanisms facilitating payment in money and the transfer of monetary value, particularly in the discharge of debts. The law that governs the payment order has thus developed in tandem with the evolution of the payment system.

The 'payment system' is concerned with the transfer of 'money' and 'monetary value'. 'Money' has been developed (though not necessarily invented) to overcome the inherent drawbacks of a barter system and thereby to facilitate an exchange economy. In its simplest sense, the payment of a debt contemplates payment of money in specie namely, the physical delivery of monetary objects – presently taking the form of banknotes and coins – from a debtor to his creditor. This method of payment requires the availability of the monetary objects in the debtor's hands, and their physical delivery or transportation to the creditor.

Together with paper money, non-cash payment mechanisms have developed as a response to the scarcity of coins as exclusive monetary objects; however, payment mechanisms evolved also as a means to reduce, or even to eliminate altogether, costs and risks involved in the transportation of monetary objects, being coins or banknotes, in payment of debts.

A payment mechanism can be broadly described as any machinery facilitating the transmission of money or monetary value in the payment of a debt, which enables the debtor to avoid the transportation of money in specie and its physical delivery to the creditor in the discharge of the debt. Monetary value is formed by a claim to receive monetary objects. A payment mechanism is thus concerned with the transfer of 'monetary value' rather than monetary objects. Its operation is premised on the discharge of a debt by virtue of an authorized payment made by a third party ('paymaster'), frequently a debtor's debtor. It is an instruction issued under the debtor's authority which triggers the paymaster's power to make payment and transfer 'monetary value' from the debtor to the creditor. Though the paymaster's payment to the creditor *may* be carried out in specie, from the debtor's perspective, payment is made by means of 'monetary value' passing between him and the paymaster.

Besides discharging the original debt owed by the debtor to the creditor, the paymaster's payment discharges the debt owed by the paymaster to the debtor. Alternatively, where there is no such pre-existing debt owed by the paymaster to the debtor, this payment, besides discharging the original debt, creates a new debt owed by the original debtor to the paymaster. Either way, it is a 'monetary value' which is transferred between them. Frequently, the debt owed by the paymaster to the debtor, discharged by the paymaster's payment to the creditor, is on a deposit of money; similarly, payment by the paymaster to the creditor is likely to be into a deposit account of the creditor. Deposit-taking financial institutions are broadly referred to as banks. Hence, the payment system has primarily developed as a side-product to the emergence, evolution and growth of transfer and deposit banking.

Broadly speaking, a national payment system refers to an entire scheme consisting of institutions, arrangements and rules facilitating monetary payments in a country, as well as into and out of it, usually in particular in the currency that country adopted.<sup>1</sup> To that end, a national payment system may be defined as 'the configuration of diverse institutional arrangements and infrastructures

<sup>1</sup> That currency is referred to as the 'national currency' or 'official currency' of the country. It is the unit of account in which prices are set and whose value is guarded by the central bank. Coins and banknotes ('currency') denominated in that unit of account are usually 'legal tender', in which a debtor may pay and which a creditor must accept in discharge of private and public debts. 'Currency' and 'national currency' are defined (albeit incompletely) eg in BA Garner (ed in chief), *Black's Law Dictionary*, 9th edn (St Paul MN: West, 2009) at 440, 979. For more satisfactory definitions of 'legal tender' visit [www.merriam-webster.com/dictionary/legal%20tender](http://www.merriam-webster.com/dictionary/legal%20tender) or [www.wikipedia.org/wiki/Legal\\_tender](http://www.wikipedia.org/wiki/Legal_tender). As discussed immediately below, typically, the central bank is the guardian of the value of that unit of account, the issuer of coins and banknotes denominated in it, and the depository of domestic banks' reserve or settlement accounts in that unit of account.

that facilitates the transfer of monetary value between . . . parties.<sup>2</sup> It thus involves cash payments (effectively in banknotes and coins) and non-cash payments. The latter are said to ‘typically involve a complex process of money transfers from the deposit (or credit) account of the payer at one financial institution to the account of the payee at another financial institution.’<sup>3</sup> More specifically, the modern payment system has been described as consisting of ‘a complex set of arrangements involving such diverse institutions as currency, the banking system, clearing houses, the central bank, and government deposit insurance.’<sup>4</sup> Among these institutions, ‘currency’ refers to cash, or to coins and banknotes.<sup>5</sup> Government deposit insurance is a facility provided to depositors, insuring them against the insolvency of their deposit-taking bank. It is designed to pool the risk of individual bank failures and thus encourage reliance on the banking system as a whole. Nevertheless, deposit insurance is not an indispensable element of a payment system. Clearing houses or facilities are designed to execute interbank handling of payment instructions with a view to settling resulting obligations. Both deposit insurance and clearing houses are incidents relating to the functioning of the banking system. As for the central bank, it operates in the payment system primarily within its double role as (i) the issuer of banknotes, and sometime coins, denominated in the national currency,<sup>6</sup> as well as (ii) the bankers’ bank holding settlement or reserve accounts for them.<sup>7</sup>

It is thus the banking system, with the central bank at its head, which serves as the backbone of the non-cash payment system.<sup>8</sup> The non-cash payment system

<sup>2</sup> Committee on Payment and Settlement Systems (CPSS), *General Guidance for National Payment System Development* (Basle: Bank for International Settlements, January 2006) at 7.

<sup>3</sup> *Ibid.* Certainly, however, in this definition, ‘money transfer’ is not physical but rather in terms of ‘monetary value’.

<sup>4</sup> MS Goodfriend, ‘Money, Credit, Banking, and Payment System Policy’, in DB Humphrey (ed), *The US Payment System: Efficiency, Risk and the Role of the Federal Reserve* (Boston: Kluwer Academic Publishers, 1990) at 247.

<sup>5</sup> This is to be distinguished from the ‘national currency’ or ‘official currency’ of a country as discussed in n 1 above.

<sup>6</sup> *Ibid.*

<sup>7</sup> ‘Defining central banking is problematic. In one sense we recognise it when we see it.’ See F Capie, C Goodhart and N Schnadt, ‘The Development of Central Banking’, in F Capie, C Goodhart, S Fischer and N Schnadt, *The Future of Central Banking – The Tercentenary Symposium of the Bank of England* (Cambridge: Cambridge University Press, 1994) 1 at 5. Briefly stated, the central bank is the issuer of the national currency and guardian of its value. As a bank, its main clients are the government (for which it acts as a financial agent) and commercial banks. For the latter it also acts as a lender of last resort. With respect to the financial and payment systems, it is charged with oversight, and may be assigned regulatory powers. Additional tasks may relate to management of debt and foreign exchange reserves as well as exchange controls. See in general, RM Lastra, *Central Banking and Banking Regulation* (London: Financial Market Group, 1996) at 250–86 (Appendix: ‘Evolution of the Functions of a Central Bank: A Rationale of Central Banking’). See also: JA Spindler and BJ Summers, ‘The Central Bank and the Payment System’, in BJ Summers (ed), *The Payment System – Design, Management and Supervision* (Washington: International Monetary Fund, 1994) at 164, and M Manning, E Nier and J Schanz (eds), *The Economics of Large-value Payments and Settlement: Theory and Policy Issues for Central Banks* (Oxford: Oxford University Press, 2009) at 137–203 (Part III: Public-policy intervention in payment and settlement systems).

<sup>8</sup> The central bank’s role is compromised in monetary systems in which the amount of currency in circulation together with banks’ balances in reserve accounts is backed by 100% foreign currency.

has been described as ‘an inverted pyramid’<sup>9</sup> with ‘the broad base of economic actors whose daily activity in the market economy gives rise to payment obligations’,<sup>10</sup> made through banks, ‘with the central bank at the apex.’<sup>11</sup> Typically, a non-cash payment between a payer and a payee presupposes both to have accounts with financial institutions, usually banks, and a payment order instructing payment. Payment orders could be written or issued electronically; they can further be processed manually or in automated systems. For such payment orders, where the payer and payee have accounts in different banks, interbank clearing is required, followed by interbank settlement which, between two domestic large banks, is typically carried out over the books of the domestic central bank. The architecture of the modern payment system is thus premised on customers, linked to banks, which in turn are linked to a central bank, with funds moving across bank accounts by means of customers’ payment orders. Large banks act as correspondents for domestic small banks and cross-border or overseas other large banks. Payment orders could be transmitted in various media, and fall into diverse categories of payment mechanisms, such as paper cheques, wires (cables), or electronic messages initiated by the insertion of cards.

Certainly, this framework was not created overnight. Over the centuries it has been shaped by available technology, institutional organizations, and social as well as economic conditions. By the same token, the law that governed the payment system was not invented instantaneously. Rather, the law evolved step by step, generally speaking, in tandem with the progress in the evolution of the payment system. This book explores the origins of this law as it has emerged, developed and crystallized in the West<sup>12</sup> during Antiquity and the Middle Ages and as it has transformed upon entering the Modern Era.

This is the case in a national payment system either in foreign currency or in currency issued by a local currency board. For the latter see eg SK Tsang, ‘Legal Frameworks of Currency Board Regimes’ (August 1999) *Hong Kong Monetary Authority Quarterly Bulletin* 50.

<sup>9</sup> EG Corrigan, ‘Luncheon Address: Perspectives on Payment System Risk Reduction’, in Humphrey, above n 4 at 129, 130.

<sup>10</sup> HI Blommestein and BJ Summers, ‘Banking and the Payment System’, in Summers, above n 7, 15 at 27.

<sup>11</sup> BJ Summers, ‘The Payment System in a Market Economy’, in BJ Summers, *ibid* at 1, 5.

<sup>12</sup> Other than Europe, ‘West’ is broadly defined to include North Africa, the Levant, and Mesopotamia, and to some extent Persia, all of which are places on the route to modern money, payment systems, and banking. This is not to say that parallel developments did not occur in the East. See eg C Eagleton and J Williams, *Money: A History*, 2nd edn (London: British Museum Press, 2007) at 135–43 (or more generally for money in India and South-East Asia at 108–34, and in China and the East at 135–61). However, ‘the route to modern money follows the general course of Hellenistic and Romanized western civilization.’ See G Davies, *A History of Money From Ancient Times to the Present Day*, 3rd edn (Cardiff: University of Wales Press, 2002) at 55. For a brief discussion on early Chinese money (as well as questioning the claim of Chinese ancestry to coined money), see also AR Burns, *Money and Monetary Policy in Early Times* (New York: AM Kelley, 1965, reprint 1927) at 50–51, as well as at 58.

## 3. DESCRIPTION

The book contains 12 chapters. Each chapter is self-contained and can be read on its own. However they are all interwoven into one theme. Here lies the benefit of reading the book as a whole. Throughout the book the discussion is interdisciplinary, relying on literature both in economic and financial history and in law. Not infrequently it addresses complex multi-party settings.

Illustrations at the back of the book are designed to help the reader to follow principal settings. The description in the book of each setting is designed to be self-explanatory; at the same time, it is only natural that the use of illustrations will enhance comprehension and facilitate smoother reading. An illustration associated with a specific chapter identifies that chapter. However, several illustrations are ‘versatile’ in the sense that they are relevant for most (or at least more than two) chapters – in which case they do not specify any particular chapters with which they are associated.

Chapter one discusses fundamentals, namely, money, payment in money, and the order to pay money; the latter underlies a non-cash payment by means of a payment mechanism. The discussion in this chapter draws primarily on the common law; it is designed to provide for an overall approach to these concepts, rather than to trace their exact evolution in each legal system. The objective is to lay down the conceptual framework for the legal analysis that follows. In the ensuing chapters, the legal analysis is carried out in the context of the contemporary institutional arrangements of the various legal systems which are relevant in each part of the specific period under discussion, throughout Antiquity and the Middle Ages, through to the present day.

Chapter two deals with money and monetary legal theory in Antiquity and the Middle Ages. It covers the origins and early development of money, monetary legal theory under the Talmud, and the evolution of monetary legal theory in Roman law and the Common Law of England. This evolution moved, ultimately, from metallism to nominalism. The chapter discusses the origins and the legal nature of metallic money and examines the roots of nascent bank money.

Chapter three deals with funds transfers in antiquity. It discusses instruments, institutions and mechanisms. It covers the origins of banking services in Ancient Mesopotamia, the roots of deposit banking as well as funds transfers in Ancient Greece and Ancient Rome, and the consolidation of the mechanisms and institutions in Greco-Roman Egypt prior to the great collapse of the early Medieval period in the West.

Chapter four explores possible legal foundations for the cheque in the Jewish Talmud. The Talmud is the summary of the oral law that evolved after centuries of post-biblical scholarly effort by the Jewish sages who lived in Eretz-Yisrael (Palestine, being biblical Canaan, or Judea as it was until shortly after the turn of the Common Era (CE)) and Babylonia. It is the central pillar of Judaism and



the cornerstone of Jewish law. Its compilation was completed in Babylonia in the fifth century CE. Eminent historians single out the Talmud as being a unique legal text in Antiquity providing for a framework facilitating at least a limited cheque system. The chapter is an in-depth analysis of the Talmudic passage and related Commentaries from which the existence of the cheque is said to derive. While highlighting the contribution of the Talmud's discussion to the legal issues pertaining to cheques, the chapter concludes against the existence of cheques and a cheque system under the Talmud.

Chapter five discusses the payment order under Roman law. Following a brief introduction to pertinent aspects of the Roman law of contract, the chapter discusses the irregular deposit, the delegation order, the *receptum* and *constitutum*, the execution of delegation primarily by novation and stipulation, the cession of a monetary debt, and the application of the legal framework to mechanisms for the circulation of credit and payment to a distant party. The focus on Roman law is predicated on several distinct considerations. First, Roman law is the cornerstone of subsequent and present day legal systems of Continental Europe and numerous jurisdictions worldwide that have adopted civil codes, or its principles. At its inception, English common law too drew on Roman law sources. Second, as Antiquity drew to an end as an historical period, Roman power and influence spread throughout the entire Ancient World. As contemporary civilizations lost their pristine nature, their own legal systems came to absorb Roman elements, so that Roman law became a major legal system throughout the Roman Empire. However, the reverse also occurred, leading to the third reason for focusing on Roman law: that Roman law itself incorporated elements of other, co-existing legal systems. At the zenith of Roman power and influence, Roman law may have lost any measure of insularity it may have had. Having interfaced and interacted with the other legal systems of the Ancient World, it certainly assimilated many of their salient aspects. Thus, principles of Roman law, as they had been transformed from time to time, either prevailed or had influence throughout the Roman Empire since its establishment, and into or even beyond its ultimate collapse. Such principles had come to be the most inclusive of, and the better preserved among, the pertinent elements of legal systems of the entire Ancient World.<sup>13</sup>

Chapter six deals with Islamic payment instruments of the early Middle Ages and the law that evolved to cover them. Such instruments and laws emerged in the Middle East and North Africa under the Arab Empire. The chapter sets out salient elements of contract law under the major Islamic schools of law and its application to the payment mechanisms that were used. As a matter of legal doctrine, the chapter discusses the Islamic *hawale* and proceeds to analyse its application to the *suftaj* and other Islamic payment instruments. The chapter identifies important elements of negotiability, viz transferability by delivery and acceptor's liability to the holder, and yet points out some differences with

<sup>13</sup> These considerations are set out with supporting authorities in ch 3, section 1 below.

the Continental bill of exchange, subsequently discussed at length in chapter eight.

Chapter seven deals with funds transfers under Talmudic law. The legal systems of Antiquity operated in the absence of a specialized body of law which would govern the payment order both exclusively and comprehensively. Thus, the choice of the Talmudic legal system as a topic of discussion (side by side with Roman law, discussed in chapter five) is predicated on the extent of available sources as well as on the richness of relevant legal discussion both in quantity and sophistication. The discussion covers the nature of the right to money owed on a loan or deposit, direct mechanisms for the transfer of money owed, transfer by means of the authorization of a creditor to collect from a paymaster (the *urcheta*), transfer of money owed by turning the creditor's emissary to a paymaster (the *dyokani*), transfer of money owed by means of a presence-of-all-three declaration, and the transformation of the *dyokani*, in the footsteps of the Islamic *suftaj*, into a mechanism for the remittance of payment to a distant place. Chronologically, the Talmud was compiled before the emergence of Islam and Islamic law. Nevertheless, the present discussion of Talmudic law follows that of Islamic law due to the subsequent absorption of the Islamic *suftaj*, if not into Jewish legal doctrine, at least into Jewish commercial practice which necessitated a legal response during the Islamic era. Finally, chapter seven assesses the Talmudic contribution to the subject matter of this book, particularly in connection with the transfer of a documentary note of indebtedness.

Thus, the development of core banking services, such as deposit taking and transfers, throughout the course of Antiquity and the early Middle Ages, can be traced back to Mesopotamia. Money and deposit banking emerged in Greece. Greco-Roman Egypt pioneered the cheque, and further facilitated economic activity with the introduction of various types of banking institutions, extensive bank networks and diverse banking operations. Roman law had facilitated the circulation of credit in the form of a series of re-delegations or re-assignments. Jewish law had sown the seeds of transferability by delivery of debt instruments. Early Medieval Islamic law, particularly Maliki rules in Egypt, combined and enhanced both achievements. By giving effect to a mere delivery of a debt instrument accompanied by an informal agreement to transfer, these rules provided for a simple mechanism to accomplish the circulation of informal instruments of credit. Each such instrument contained the explicit undertaking of a paymaster and, as applicable, the implicit liability of his correspondent.

Chapter eight covers the Middle Ages in Christian Europe. Deposit banking declined in the early Middle Ages and in fact had not been known in Jewish and Islamic financial practices. Nevertheless, in the late Medieval Era in Continental Europe, major improvements and refinements to past achievements occurred. First, deposit and transfer banking were reborn; in this context, the cheque also reappeared. Second, the Continental bill of payment came into being. Having acquired negotiability, as well as having conferred an entitlement to enforce an abstract obligation to pay a sum of money, the Continental bill of payment

became the bill of exchange. Third, an interbank settlement mechanism for bills of payment was established. It was the forerunner of today's organized inter-bank clearing system in a multilateral setting.

Chapter nine examines the evolution of the law governing the bailment of money and bills of exchange under the Common Law of England. It positions the evolution of the law that governs both facilities in the broader context of the development of legal doctrine as to civil liability under the common law. The chapter discusses the Medieval bailment of money as the foundation of the law that governs the bank deposit. The chapter goes on to discuss the rise and fall of the Medieval bailment of money as a legal doctrine that facilitated the transfer of the deposit which was lost in the transition to modern law. In dealing with the bill of exchange, the chapter rejects the existence of 'Law Merchant' as a separate and distinct branch of law that was 'received' from the Continent to accommodate the bill of exchange imported from it. Rather, presupposing that in the late Middle Ages the bill of exchange evolved in England in tandem with its development in the Continent, the chapter supports the thesis of its accommodation in England as a matter of indigenous common law. The chapter further endeavours (i) to address the suitability of the bailment of money and bill of exchange as mechanisms underpinning legal doctrine pertaining to funds transfer; (ii) to compare the two mechanisms; and ultimately (iii) to examine their potential for convergence, as it failed to materialize. The chapter points out the distinguishing features of both the bailment of money and the bill of exchange as payment mechanisms by comparison to the Roman law delegation, Islamic *hawale*, and the cession or assignment of debts.

Chapter ten discusses post-Medieval developments in England that gave rise to a unique model, building on instruments and institutions developed earlier elsewhere. This model heralded the current framework for commercial banking as well as the architecture and institutional framework for the modern payment system. The English model also put in place the design of the present monetary system, namely the operational and institutional framework under which money is issued and becomes available for use for participants in the payment system. The chapter explores the goldsmith bank system that gave rise to cheques and banknotes; the establishment of the Bank of England and its transformation to a central bank; the legal nature of the banknote, particularly as a promissory note; and concludes with an overview of the evolution of money in the context of the birth of the modern payment system in the process described above. In the course of the evolution set out in the chapter, the nature of credit in a bank of account converged as both (i) 'monetary value' transmitted by means of a payment mechanism initiated by a payment order, and (ii) a type of 'money'.

Chapter eleven discusses negotiability as the catalyst that, in enhancing circulation, facilitated the post-Medieval transformation in England. That transformation was outlined in the previous chapter. The chapter distinguishes between procedural negotiability, or 'negotiation', and material negotiability, or the

acquisition of a 'holder-in-due-course' status. The former addresses the transferability from hand to hand, with or without endorsement. The latter addresses the ability of the acquirer of an instrument by negotiation to defeat adverse claims and prior parties' contract defences so as to have a better title than that of the transferor. The chapter discusses the evolution of negotiation, and the facilitation of procedural negotiability, for bills of exchange, promissory notes, and cheques. The chapter further discusses the evolution of the super-added quality of material negotiability. It concludes with an analysis of the nature of negotiable instrument. As in chapter nine, this chapter highlights the central role of common law doctrine rather than that of an alleged Continental pre-existing 'law merchant'. Attention is however given to a few parallel developments in Continental/civil general law that may shed light on some issues in English law.

Chapter twelve is designed to link modern funds transfer and payment law to the evolution of the law that governed the order to pay money in Antiquity and the Middle Ages. The chapter covers six principal subjects, each covered in a separate section. First, it discusses payment services in the form of funds transfers, and the providers of such services. Second, it deals with the bank deposit. Third, it presents a summary of the treatment of the payment order and its execution under modern law. Fourth, it analyses the payment order as a mandate. Fifth, it covers the autonomy and discharging effect of the paymaster's obligation. Sixth, drawing on the earlier parts of this chapter, the concluding section presents a 'revisionist' view on a 'decentralized' non-customary 'law merchant'.

Discussion covers both common and civil law in major jurisdictions and encompasses general principles of law, general legislation covering obligations, as well as specific legislation covering funds transfers, and to a lesser extent, bills of exchange and cheques.

Finally, the conflicting role of enhanced technology, as a source for both development and growing risk, is pointed out. It is also acknowledged that in light of its checkered history, the future of deposit banking may be shrouded in uncertainty; and yet, so far as we can tell, the lesson from history is that a growing payment system is to be nurtured by a healthy and successful deposit banking enterprise. Another lesson from history is the durability of legal principles discussed in this book to provide an ongoing framework for the continuous evolution of the payment system.

#### 4. CONTRIBUTION TO SCHOLARSHIP

The orthodox exposition of the history of English law of negotiable instruments is set out in numerous works, most comprehensively by Holden,<sup>14</sup> and

<sup>14</sup> JM Holden, *The History of Negotiable Instruments in English Law* (London: University of London: The Athlone Press, reprint 1993, WM W Gaunt & Sons, 1955).

more succinctly by Holdsworth.<sup>15</sup> Their exposition was challenged on some fundamental points by Rogers, who produced a heterodox or revisionist version of the history of negotiable instruments in English law.<sup>16</sup> I have drawn on the vast materials produced by the orthodox view. Yet, on the whole, being persuaded by the heterodox or revisionist view, I purported to expand the investigation on two fronts. First, acknowledging the primary place occupied by the bill of exchange both in commerce and the legal history of negotiable instruments, I nevertheless endeavoured to examine the evolution of its legal features in the broader context of a study on the order to pay money in general. Thus, this study is not in any way restricted to the law of negotiable instruments. Second, in acknowledging the non-English origins of the bills of exchange, I join the consensus among both the orthodox and heterodox sides of legal history. At the same time, I have expanded the investigation, both geographically and temporally. I thus chose to cover early developments in payment orders from other (broadly defined) Western civilizations that may have been in contact with each other (or else transmitted one to the other), and under their various legal systems. In addition to England and various components of English law, detailed coverage is thus given to Mesopotamia, the Mediterranean basin, and Continental Europe, mostly under Jewish, Roman and Islamic laws.

My research draws particularly on published legal sources and literature in law, economic history, economic thought, banking and economics, in various languages.<sup>17</sup> I carried out the investigation in a broad historical and institutional context, purporting to tie fragments of existing knowledge into a cohesive evolutionary theory. Naturally, making my way through vast materials in disciplines other than in law, particularly in economic and financial history, I encountered disputed points and controversies which are beyond my expert ability to resolve. In all such cases, with or without an expression of an opinion on my part, I aimed at describing the entire picture by citing and addressing the various views on that particular matter.

I endeavoured to present an holistic view on the legal history of the order to pay money, integrating doctrine from various legal systems and studies into a complete picture of parallel, overlapping and successive developments, occurring in various places, at different times, and under diverse institutional arrangements and technologies. All this has led to what is now a global payment system, operated under legal principles and rules which have kept proximity to each

<sup>15</sup> W Holdsworth, *A History of English Law*, 2nd edn (London: Methuen & Co, Sweet and Maxwell, 1937, reprinted 1966) vol VIII at 99–177.

<sup>16</sup> JS Rogers, *The Early History of the Law of Bills and Notes: A Study of the Origins of Anglo-American Commercial Law* (Cambridge: Cambridge University Press, 1995).

<sup>17</sup> English, French, Hebrew, Talmudic Aramaic, and Law French. Linguistic limitations precluded me from relying directly and independently on materials in German, Italian, Greek, Latin, Arabic, Judeo-Arabic, Demotic, Coptic, Flemish, Dutch, Ottoman Türk, Spanish, Portuguese and ancient languages of Mesopotamia. I used official and unofficial translations as needed and acknowledged. Certainly, greater linguistic knowledge would have improved the study and yet had I been endowed with required linguistic capabilities I might have been tempted to direct my talents to other pursuits – perhaps more financially profitable – than legal research.

other throughout time, place, stages of human development, as well as religious, social and political orders.

Good ideas do not die; when they temporarily lose their usefulness, they become dormant, only to be reborn in an improved form when their time comes to meet new needs of ever-evolving commerce. In a nutshell, in their (so far) final incarnation, as Continental Europe was exiting from the Dark Ages towards the late Medieval Era, payment orders and deposit banking re-appeared. Principles emerging from Roman law evolved to govern them. Practices and instruments used in Islamic lands may have been a source of inspiration. Subsequently, in adapting its coverage to accommodate Medieval instruments and institutions, post-Medieval England gave rise to modern banking, including the architecture of the modern payment system. English law developed its own principles and doctrines to cover the adapted instruments and institutions. As the overall architecture of the payment system, including its instruments, practices and institutions, ‘migrated’ to Continental Europe, a fusion of old principles, shaped into new codes of law deriving from Roman law, and new ones, designed to accommodate the new ‘imports’ from across the Channel, had taken place, so as to allow for a convergence of principles and rules of law.

What was transmitted from one generation to another and what was reinvented is not always easy to discern. Civilizations that embrace institutions from others do not necessarily give credit to another civilization’s innovation. On occasion, however, it is possible to speculate. Thus, as will be seen in chapter three, section 5 below, cheques originated in Greco-Roman Egypt in the early years of the first century BCE. Their re-emergence in Continental Europe during late Middle Ages, as an improvement to the transfer of funds between deposits kept in the same bank, discussed in chapter eight, section 2 below, is probably a true re-invention. Conversely, the introduction by Islamic jurisprudence of the informal transferability of debt instruments, discussed below in chapter six, may not have been necessarily ‘original’; rather, due to the close contact between Islamic and Jewish civilizations in the Islamic lands around the turn of the first millennium CE, familiarity by the Islamic legal system of the transferability of debt instruments in Jewish law as discussed below in chapter seven, cannot persuasively be dismissed. At the same time, as discussed in chapter eight, section 2 below, having existed in Antiquity, as discussed in chapter three, it is nevertheless hard to determine conclusively whether, in the late Middle Ages, deposit banking was re-invented anew, or was re-constituted on the basis of transmission.

In the final analysis, insofar as the legal framework is concerned, though convergence with Roman law cannot be denied, having given birth to the modern architecture of the payment system, it is English legal doctrine that was dominant in the evolution of the payment system and that laid the foundations to the modern law that governs money, payment and funds transfers initiated by payment orders. Indeed, Rogers correctly pointed out that on its own, ‘negotiability’ may have not been all that central to the evolution of the law of bills and

notes;<sup>18</sup> and yet, as pointed out below in chapter eleven, even if more by accident than by design, ‘negotiability’ was the cornerstone, the central pillar, for the transformation and rebirth of the modern payment system in post-Medieval England.

At the same time, the various components of relevant legal doctrines, practices and institutions, evolved previously and elsewhere. They are rooted in Mesopotamia, in Ancient Greece as well as in Ancient Rome; in the works of the sages of the Talmud in Ancient Judea and later in Babylonia, as well as in Greco-Roman Egypt; in the legal doctrines, practices and traditions that evolved in the Islamic lands, as well as in practices of Medieval bankers and merchants. This is, however, not to adopt Ecclesiastes verbatim and say that ‘there is nothing new under the sun’ and that everything ‘hath been already, in the ages which were before us.’<sup>19</sup> Indeed, the contribution of the past, in the form of ongoing adaptation of old legal doctrines and evolution of new institutions out of old ones, is not to be undermined; at the same time, even in the process of transmission, and certainly in connection with a re-invention, innovation has been constant, albeit, only too often in the form of the re-invention of the wheel. The exploration of principles that underlay that process of innovation, based on the ongoing renaissance of old doctrines, institutions and instruments, is the theme of the present work.

<sup>18</sup> Rogers, above n 16.

<sup>19</sup> Bible, *The Holy Scriptures According to the Masoretic Text* (Philadelphia: The Jewish Publication Society of America, 1955) Ecclesiastes 1: 9–10.





# 1

## Money, Payment in Money, and the Order to Pay Money

|                                                                                                |    |
|------------------------------------------------------------------------------------------------|----|
| 1. Introduction                                                                                | 16 |
| 2. Money                                                                                       | 17 |
| 3. Payment in Money                                                                            | 25 |
| 3.1 The Meaning of ‘Payment’                                                                   | 25 |
| 3.2 Tender of Money                                                                            | 26 |
| 3.3 The Process of Payment: Completion, Risk and Remedies                                      | 32 |
| 4. The Order to Pay Money: The Concept of a Payment Mechanism                                  | 37 |
| 4.1 Transmission of Monetary Value: General Framework                                          | 37 |
| (i) The Basic Model                                                                            | 37 |
| (ii) The Three-party Payment Mechanism                                                         | 39 |
| (iii) Multipartite-payment Mechanisms                                                          | 45 |
| 4.2 Transmission of Monetary Value: Legal Issues                                               | 47 |
| (i) Introductory Notes                                                                         | 47 |
| (ii) Three-party Payment Mechanism                                                             | 47 |
| <i>The Issues</i>                                                                              | 47 |
| <i>First and Second Issues: Paymaster’s Duties towards</i>                                     |    |
| <b>Debtor and Creditor</b>                                                                     | 49 |
| <i>Second Issue: Scope of Creditor’s Entitlement</i>                                           | 52 |
| <i>Third Issue: Debtor’s Discharge</i>                                                         | 54 |
| <i>Fourth Issue: Paymaster’s Discharge</i>                                                     | 55 |
| <i>Discharge: Summary</i>                                                                      | 56 |
| (iii) Four-party Money-transmitter Payment Mechanisms                                          | 56 |
| (iv) Four-party Banker Payment Mechanisms                                                      | 58 |
| 4.3 Conclusion                                                                                 | 60 |
| 4.4 Addendum: Payment by Paymaster’s Obligation and the Evolution of Modern Payment Mechanisms | 61 |

## 1. INTRODUCTION

THIS CHAPTER DISCUSSES fundamentals; namely, money, payment in money, and the order to pay money; the latter underlies a non-cash payment by means of a payment mechanism. The discussion in this chapter draws primarily on the common law; it is designed to provide an overall approach to these concepts, rather than to trace their exact evolution in each legal system or even in a broader comparative context. The objective is to lay down the conceptual framework for the legal analysis that follows later in the book. The legal analysis is carried out in the following chapters in the context of the contemporary institutional arrangements and the various legal systems which are relevant in each part of the period under discussion. The entire period extends from Antiquity, through the Middle Ages, up to the dawn of the modern era.

In the present chapter, to the extent possible,<sup>1</sup> ‘money’ is used in its strictest sense, referring exclusively to monetary objects which, currently, are banknotes and coins.<sup>2</sup> In this sense, ‘money’ is interchangeable with ‘cash’ or ‘currency’ and is to be distinguished from ‘monetary value’. The latter addresses both the function of ‘money’ as a standard unit of value and its possible abstract form, typically as a credit to an account. In that latter sense, ‘monetary value’ is usually convertible to ‘money’ in its concrete form, viz to banknotes and coins. Stated otherwise, ‘monetary value’ is formed by a claim to ‘money’. Thus, payment in money entails the physical delivery of banknotes and coins. At the same time, to the extent it is not applied in the exercise of a bilateral set off between a debtor and creditor,<sup>3</sup> the payment in ‘monetary value’ is necessarily by means of a ‘payment mechanism’. It is to that end that the juxtaposition of ‘money’ and ‘monetary value’ is helpful for the purpose of the present chapter.

Section 2 examines ‘money’ as consisting of physical objects. Section 3 examines ‘payment in money’ as the delivery of such physical objects and further highlights practical difficulties inherent in a method for the discharge of monetary debts premised on the physical delivery of money. Section 4 sets out the nature of a payment mechanism as a method for the discharge of monetary debts by means of a transfer of ‘monetary value’, initiated by a payment order. As such, this chapter lays down the framework for the ensuing historical discussion of the book.

<sup>1</sup> This restrictive use, and the distinction on which it is premised, cannot however be universally observed. Frequently, it conflicts with common language. Such is the case, eg, when a bank deposit is said to contain ‘money’ rather than ‘monetary value’ or when the transmission of monetary value from one place to another is said to be ‘money transmission’. Perhaps in such cases the distinction is blurred, respectively, because of the convertibility of the deposit to ‘money’ in a concrete form and the possible execution of the money transmission in the form of payment in banknotes at the destination.

<sup>2</sup> FH Lawson and B Rudden, *The Law of Property*, 3rd edn (Oxford: Oxford University Press, 2002) at 43.

<sup>3</sup> The latter is a method of payment which does not involve ‘transfer’. See D Fox, *Property Rights in Money* (Oxford: Oxford University Press, 2008) at 30.

## 2. MONEY

Money has not been generated by law. In its origin it is a social and not state institution. . . . On the other hand, however, by state recognition and state regulation, the social institution of money has been adjusted to the manifold and varying needs of an evolving commerce.<sup>4</sup>

This section outlines both the function and essence of money as it evolved.

Money is said to be a medium of exchange, a store of value,<sup>5</sup> and a unit of account.<sup>6</sup> Fulfilling these functions, money is essential to the smooth operation of an exchange economy as well as to the accumulation of wealth it allows. Money both facilitates the exchange and ‘acts as a measure . . . making things commensurable.’<sup>7</sup> At the same time, money is not needed in a society consisting of self-sufficient economic units;<sup>8</sup> nor is it required in an utopian society in which products ‘are not exchanged, bought or sold’ but rather are ‘stored in the communal warehouses, and are subsequently delivered to those who need them.’<sup>9</sup> For an exchange economy, however, money is the lifeline.<sup>10</sup>

<sup>4</sup> K Menger, ‘On the Origin of Money’ (1892), 6 *Economic Journal* 239 at 255 (trans by CA Foley). Certainly, the role of the state is a subject for discussion as well as disagreement. Compare eg JK Galbraith, *Money: Whence It Came, Where It Went* (London: Andre Deutsch, 1975) and FA Hayek, *Denationalisation of Money—The Argument Refined*, 3rd edn (London: The Institute of Economic Affairs, 1990).

<sup>5</sup> WS Jevons, *Money and the Mechanism of Exchange* (London, Henry S King & Co, 1875) at 13 does not include this element in the definition. Indeed, money is a store of value only in the sense of being a ‘surplus’ liquid resource available in one’s hands for acquiring new commodities as may be needed and wished.

<sup>6</sup> N Dodd, *The Sociology of Money: Economic, Reason & Contemporary Society* (New York, Continuum, 1994) at xv. For G Ingham, *The Nature of Money* (Cambridge UK and Malden Mass: Polity, 2004) eg at 198, ‘money’ is effectively something that ‘[r]egardless of its form and substance’ answers the promise and description provided (and measured) by the unit of account.

<sup>7</sup> JAK Thomson, trans, *The Ethics of Aristotle* (Harmondsworth, NY: Penguin Classics, 1955) at 154. In Aristotle’s view, while ‘money is subject to the vagaries of the market just like other commodities . . . its purchasing power . . . is pretty constant.’ *Ibid* at 153–54, discussing in general the function of money in exchange of commodities. His account is said to be in line with that of Plato. See AR Burns, *Money and Monetary Policy in Early Times* (New York: AM Kelley, 1965, reprint 1927) at 457, 458.

<sup>8</sup> They can engage in a limited exchange through barter which according to Aristotle, *The Politics*, trans by TA Sinclair (Harmondsworth: Penguin Books, 1962, reprint 1976) at 42, is not ‘contrary to nature’. Conversely, extensive commercial exchange depends on money, which according to him, *ibid* at 46, ‘is justly regarded with disapproval, since it arises not from nature but from men’s dealing with each other.’ See in general, *ibid* at 38–46.

<sup>9</sup> For this description of the communist method of production, see N Bukharin and E Preobrazhensky, *The ABC of Communism*, trans by EC Paul (Harmondsworth: Penguin Books, 1969) at 116–17. See also [www.geocities.com/~Johngray/stanmond.htm](http://www.geocities.com/~Johngray/stanmond.htm) for an article from the *Socialist Standard* (the journal of the Socialist Party of Great Britain World Socialist Movement) of July 1979, translating extracts from the first volume of *Les Amis de 4 Millions de Jeunes Travailleurs* (1975–76), *Un Monde Sans Argent: Le Communisme*. The article states that money ‘is not a neutral instrument of measurement’ so that it ‘will disappear’. Ultimately, ‘[i]n communist societies goods will be freely available and free of charge. The organisation of society to its very foundations will be without money.’

<sup>10</sup> See eg A Smith, *The Wealth of Nations* Books I–III, with Introduction by A Skinner (London: Penguin, 1970; reprint 1986; first published 1776) at 126–32 (Book I Chapter IV) and 135, 148 (Book

In modern times, economists take the narrow ‘monetary base’ of a country to consist of the obligations of its central bank, both on banknotes it issues and on deposits it holds for commercial banks in their settlement (or reserve) accounts. The broader ‘money-supply’ in the hands of the public is taken to consist of such banknotes issued by the central banks (plus coins for small change issued either by the central bank or a government agency), together with demand deposits, held by the public in commercial banks. It is this ‘money supply’ that reflects the purchasing power of a given society.<sup>11</sup>

At the same time, both economists and lawyers have been looking for definitions that transcend contemporary institutional arrangements, and that capture instead the concept of ‘money’ as it evolves. ‘Money’ is thus defined in a leading English case to be ‘that which passes freely from hand to hand throughout the community in final discharge of debts . . . being accepted equally without reference to the character or credit of the person who offers it and without the intention of the person who receives it to consume it’.<sup>12</sup> This judicial definition is in line with an economist’s perspective, according to which money is anything that is widely accepted in payment for goods, used as a medium of exchange, and expressed as the standard unit in which prices and debts are measured.<sup>13</sup>

Viewing this position as nevertheless too broad for the lawyer, FA Mann drew a distinction ‘between money in its concrete form and the abstract conception of money’.<sup>14</sup> This juxtaposition echoes and confirms a distinction already made in the study on the origins of money. That is, money as an abstraction, meaning a unit of value in which prices and penalties are set, preceded the coin, or in fact any particular object, as the physical embodiment of such a unit of value or a medium of exchange in a specified denominated value.<sup>15</sup> Moreover, despite its immense contribution to the facilitation of exchange, it may well be that ‘money’, not only in its concrete form as a medium of exchange,<sup>16</sup> but also as a uniform measure of value, may not necessarily have emerged or been invented to improve commerce. This is so notwithstanding the mythology to the

I Chapter V). For the political economy of money in the context of its role in exchange economy, including an analysis of the position of both Adam Smith and Karl Marx as well as other leading thinkers, see Dodd, above n 6 at 1–23.

<sup>11</sup> This is so since the essence of banking is lending the money on deposit, so that effectively both the depositors and borrowers can use it. For a detailed economic perspective, see eg H Binhammer and PS Sephton, *Money Banking, and the Canadian Financial System*, 8th edn (Nelson: Thomson Learning, 2001) at 197–220 (banking and the creation of money) and 387–432 (monetary controls and central banking).

<sup>12</sup> *Moss v Hancock* [1899] 2 Q.B. 111 at 116.

<sup>13</sup> See eg DH Robertson, *Money* (Chicago: University of Chicago Press, 1962) at 2–3.

<sup>14</sup> FA Mann, *The Legal Aspect of Money*, 5th edn (Oxford, Clarendon Press, 1992) at 5. The tension between these two perspectives, as part of an extensive discussion on the concept of money, which also points at differences in the approaches of the economist and the lawyer, is highlighted throughout ch 1 (at 5–55, which are paras 1.01–1.76 of the subsequent edition by C Proctor, *Mann on the Legal Aspect of Money*, 6th edn (Oxford: Oxford University Press, 2005)).

<sup>15</sup> See P Grierson, *The Origins of Money* (London: Athlone Press, 1977, being the Creighton Lecture in History, 1970).

<sup>16</sup> RM Cook, ‘Speculations on the Origin of Coinage’ (1958) 7 *Historia* 257 at 259–60.

contrary.<sup>17</sup> Rather, as a uniform measure of value, its roots may be traced to the practice of *wergeld*, ‘that of paying compensation primarily for the killing of a man but . . . by extension [also] for injuries to himself or his family and household.’<sup>18</sup> Certainly, however, commerce and the exchange economy account for the improvement and further development of money.

Ancient texts support the existence of ‘money’ as an abstract unit of value, ahead of its emergence in a concrete form as a universal medium of exchange. The abstract unit could originally be a standard item of value by reference to which the value of other objects, that may have been bartered, was measured.<sup>19</sup> Gradually, the standard unit of value became a specified weight of a generic item such as staple or precious metal.<sup>20</sup>

Indeed, the period covered by the Hebrew Bible<sup>21</sup> is well before the appearance of coined money.<sup>22</sup> Nevertheless, the Hebrew Bible is full of references to ‘money’. True, in Hebrew, one word, ‘*kessef*’, denotes both ‘silver’ and ‘money’. Furthermore, in ancient times, units of account for payment and unit of weights<sup>23</sup> were interchangeable.<sup>24</sup> On occasion, it is obvious that a biblical reference to ‘*kessef*’, even as a means of payment, is made to silver, to be weighed. This is so, for example, when the Patriarch Abraham weighs to Ephron 400 ‘shekel *kessef*’ in payment of the Cave of the Machpela in Hebron.<sup>25</sup> However, elsewhere, the Hebrew Bible is more ambiguous in referring to ‘*kessef*’ as well as to units of which it consists as a medium of exchange for buying and selling,<sup>26</sup> as well as something which is lent,<sup>27</sup> in which valuation is made<sup>28</sup> and both prices<sup>29</sup> and

<sup>17</sup> Promoted by eminent thinkers such as Aristotle and Adam Smith. See eg: Aristotle, *Politics*, above n 8 at 41–46, and A Smith, above n 10 at 126–32. This mythology also draws other classical authors such as Herodotus and Xenophon. See eg C Egleton and J Williams, *Money: A History*, 2nd edn (London: British Museum Press, 2007) at 27–28.

<sup>18</sup> Grierson, above n 15 at 19.

<sup>19</sup> See eg Grierson, *ibid* at 16 referring to the ox as the standard of value in Homeric society.

<sup>20</sup> Grierson, *ibid* at 29–33.

<sup>21</sup> The Hebrew Bible largely corresponds to the Christian Old Testament.

<sup>22</sup> Certainly, the Hebrew Bible purports to cover events that preceded the appearance of the coin in Lydia in the 7th century BCE, to be discussed below in ch 2, section 1.

<sup>23</sup> For biblical weights see eg R Kletter, *Economic Keystones: The Weight System of the Kingdom of Judah*, (Sheffield, Eng: Sheffield Academic Press, 1998), being Journal for the Study of the Old Testament Supplement Series, at 276.

<sup>24</sup> Interchangeability is reflected in the correspondence between coins and weight units mentioned in the Talmud. See A Steinsaltz, *The Talmud – The Steinsaltz Edition – A Reference Guide* (New York: Random House, 1989) at 291, 293. Even up to modern times, some currency names correspond to those of unit of weights. This is true, eg, for the dollar, pound, mark, dinar, and shekel.

<sup>25</sup> Bible, Genesis 23:16, which according to some translations, was ‘current money with the merchant’. See eg *The Holy Scriptures According to the Masoretic Text* (Philadelphia: The Jewish Publication Society of America, 1955). See also Isaiah 55:2; Esther 3:9; Ezra 8:25–26.

<sup>26</sup> *Ibid* Genesis 17: 23 and 27; Exodus 12: 44; 21:21; Leviticus 22:11; Deuteronomy 2:6; 21:14; I Kings 21:2; Isaiah 1:22; 43:24; 55:1.

<sup>27</sup> *Ibid* Exodus 22:24; Leviticus 25:37.

<sup>28</sup> *Ibid* Leviticus 5:15; 27: 3–8, 15, 17, 19, 23, 25, and 27; Numbers 18:16.

<sup>29</sup> *Ibid* Genesis 33:19; Joshua 24:32; I Samuel 9:8; Isaiah 7:23; Jeremiah 32: 9–10; Song of Songs 8:11; II Chronicles 1:17; 25:6.

penalties<sup>30</sup> are set and payments are to be made.<sup>31</sup> There is also a reference to ‘*kessef*’ as something that, at least compared to agricultural produce, is easily bundled and hence portable.<sup>32</sup> At one point ‘*kessef*’ is described as countable, hence, passing by tale.<sup>33</sup> It is also referred to as something that is more liquid than other items of property.<sup>34</sup> Hence, there is a reference to a system of valuation as well as possibly to diverse and not always identified objects assessed according to such a system and used as a medium of exchange at the value they denote.

The documentary evidence from Ancient Mesopotamia supports the existence of an extensive monetary system without specific objects serving exclusively as money. Thus, under a complex monetary system, various commodities served as both units of account and means of payment. Such commodities first served as a basis for a price system, based on their comparative or relative value. Second, such commodities served as actual means or money of payment. Principal commodities were grain and precious metal, usually barley and silver.<sup>35</sup> Commodities of this type have both (i) actual use value or intrinsic utility, and (ii) economic value facilitating their use to provide a standardized means for both the measurement of the value of other commodities as well for paying for all such other commodities. As such they constituted ‘primitive money’.<sup>36</sup> For example, Hammurabi’s Code of around 1727 BCE prescribes penalties and payment obligations measured by reference to quantities of precious metal (silver) or grain.<sup>37</sup>

<sup>30</sup> *Ibid* Exodus 21:32–35; 22:16; Deuteronomy 22:29.

<sup>31</sup> *Ibid* Exodus 30: 12–15; Judges 16:5 and 18; Isaiah 52:3; Esther 3:11; Ezra 3:7.

<sup>32</sup> *Ibid* Deuteronomy 14:25–26. See also Proverbs 7:20.

<sup>33</sup> *Ibid* II Kings 12: 10–12.

<sup>34</sup> *Ibid* Genesis 47: 14–18.

<sup>35</sup> See in general RFG Sweet, *On Prices, Money and Money Uses in the Old Babylonian Period* (Unpublished PhD dissertation submitted to the Department of Oriental Languages and Civilizations of the University of Chicago, IL, 1958, available through UMI Dissertation Services, Ann Arbor Michigan); and MA Powell, ‘Identification and Interpretation of Long Term Price Fluctuations in Babylonia: More on the History of Money in Mesopotamia’ (1990), 17 *Altorientalische Forschungen* 76. See also JN Postgate, *Early Mesopotamia: Society, Economy at the Dawn of History* (London, New York: Routledge, 1992; reprint with revisions 1994), who in discussing (at 202–05) currency, observed (at 204) that ‘[i]n the early second millennium, silver was the preferred currency of the merchant class and perhaps of the administration, but even in the Old Babylonian times . . . the administration and the private sector regularly [also] used barley to fulfil the same function, and other commodities are also attested’.

<sup>36</sup> According to P Einzig, *Primitive Money*, 2nd edn (Oxford: Pergamon Press, 1966) at 317, primitive money was ‘a unit or an object conforming to a reasonable degree or to some standard of uniformity, which is employed for reckoning or for making a large proportion of the payments customary in the community concerned and which is accepted in payment largely with the intention of employing it for making payments.’ For primitive money see also AJ Toynbee, *A Study of History*, abridgement by DC Somervell (London: Oxford University Press, 1960) at 60. See below discussion in ch 2, section 1.2.

<sup>37</sup> Among the many relevant provisions, mention may be made of arts 24, 94, 104, 198, 201, 203, 204, 207, 208, 209, 211–217, 221–224, 234, 239, 241, 247, and 251. See ‘The Code of Hammurabi’, trans by J Meek, in JB Pritchard, *Ancient Near Eastern Texts Relating to the Old Testament*, 3rd edn with Supp (Princeton, NJ: Princeton University Press, 1969) at 163. Hammurabi was the sixth of 11 kings in the Old Babylonian (Amorite) Dynasty. He ruled between 1728 and 1686 BCE. *Ibid*. Precise dating is debatable; I followed the one adhered to by Pritchard.

Out of an evolutionary process, discussed in the following chapter, some time in the course of the seventh century BCE, the coin, issued under the authority of the sovereign, emerged as the standard medium of exchange, denoting a prescribed monetary value. The coin was fundamentally a piece of metal fashioned into a prescribed shape, weight, and degree of fineness, stamped by the issuer with certain designs, marks and devices.<sup>38</sup> During the seventeenth century CE, the banknote emerged as an obligation to pay coins or specie. Originally, the obligor thereon was a goldsmith, the predecessor of the deposit bank in England.<sup>39</sup> Ultimately, in the course of the eighteenth century, following the establishment of the Bank of England in 1694,<sup>40</sup> the promise to pay on banknotes circulating as money became that of the central bank.<sup>41</sup>

At its inception, and in theory<sup>42</sup> until the nineteenth century CE, the value of a coin, at least its ideal form, was primarily determined by reference to the weight of the precious metal it contained. At the same time, by definition, inasmuch as they are mere obligations to pay, banknotes are ‘fiat money’, namely, of positive nominal value, notwithstanding the worthless intrinsic value of the material of which they are made.<sup>43</sup>

Either way, the value of a coin or a banknote has always been measured by reference to a unit of account, referred to nowadays as the official currency for a given country. Originally, the value of a unit of account was measured by reference to an identical unit of weight of the precious metal of which the coin was made. Stated otherwise, in the beginning, each unit of account was the same as a unit of weight; there was thus an identity between weight and value units. Gradually, terminology changed so that even before the appearance of the paper banknote a monetary unit was not valued by reference to an identical weight unit. However, as set out immediately below, until the modern era, a monetary unit of account was anchored in the value of a specified weight of a prescribed metal. This gave the monetary unit of account its external value in terms of that metal, and facilitated the establishment of an international system under which the value of each national unit of account could be ascertained by reference to all other national units of account.<sup>44</sup> Furthermore, until the modern era, the

<sup>38</sup> See, in general, definitions of ‘coin’ in J Burke, *Jowitt’s Dictionary of English Law*, 2nd edn (London: Sweet & Maxwell, 1977) vol 1 at 368. ‘Coin in French, signifieth a corner, and from thence hath its name’. See M Hale, (d. 1676), *The History of the Pleas of the Crown*, 1st American edn by WA Stokes and I Ingresoll (Philadelphia: RH Small, 1847) vol 1 at 187, fn 2.

<sup>39</sup> JM Holden, *The History of Negotiable Instruments in English Law* (London: Athlone Press, 1955; reprint Holmes Beach, Fla: Gaunt, 1993) at 70–73 and A Feavearyear, *The Pound Sterling – A History of English Money*, 2nd edn by EV Morgan (Oxford, Clarendon Press, 1963) at 107–08.

<sup>40</sup> 5 & 6 Will & Mar c. 20 s XIX.

<sup>41</sup> See Holden, above n 39 at 87–94.

<sup>42</sup> And yet in practice, coins have been debased, namely, their intrinsic value has been lowered. See ch 2, section 1.4 below.

<sup>43</sup> See Glossary in TJ Sargent and F Velde, *The Big Problem of Small Change* (Princeton and Oxford: Princeton University Press, 2002) at 375. The term is not conceptually different to ‘token money’, referring to a coin not having the intrinsic value for which it is current. *Ibid* at 376.

<sup>44</sup> For the history of the international monetary system see eg R Lastra, *Legal Foundations of International Monetary Stability* (Oxford, Oxford University Press, 2006) at 345–70.



issuer's obligation to pay, measured by reference to a unit of account, was actually to pay that amount in specie, at least in coins. In England, this was originally true for banknotes issued by private bankers,<sup>45</sup> and subsequently, to banknotes issued by the Bank of England.<sup>46</sup> For a coin, the issuer's obligation was in the form of a guarantee as to its actual metallic content, or at least the redemption thereof.

To this day, current coins and banknotes are typically issued under state authority; at least for banknotes, the issuer is usually the central bank. However, other than the issue of coins and banknotes under state authority, by modern times, the framework just described above has been eroded, if not superseded altogether. First, in the course of the nineteenth century, the coin reflecting a fraction of the unit of account became a token, that is, a piece of metal of a value lower than that which it denotes. The division of the basic unit of account into fixed token denominations at equal abstract sub-units<sup>47</sup> is called by economists the 'standard formula'.<sup>48</sup> Thereunder, the prescribed sum of such token denominations is convertible at a fixed exchange rate to each other denomination and to the basic unit, regardless of their own metallic composition.<sup>49</sup>

Next, in the first half of the twentieth century CE, convertibility of banknotes ceased to exist; that is, the obligation to pay in specie embodied in a banknote became unenforceable.<sup>50</sup> Thus, at present, banknotes and coins express abstract obligations; they are tokens convertible to other tokens.<sup>51</sup> Finally, during the sec-

<sup>45</sup> Such notes 'accounted among merchants as ready cash'. See *Tassell and Lee v Lewis* (1701) 1 Ld. Raym. 743 at 744, 91 ER 1397 at 1398. However, 'the acceptance [by a creditor] of . . . [such a] note is not actual payment.' Rather, 'when such a note is given in payment, it is always intended to be taken under this condition, to be [absolute] payment [only] if the money be paid [in coin] thereon'. The condition was dispensed with upon the creditor's failure to demand payment in coin from the issuer 'in convenient time'. *Ward v Evans* (1702) 2 Ld. Raym. 928 at 930, 92 E.R. 120 at 121.

<sup>46</sup> Payment in Bank of England notes was held to be as good as 'payment . . . in gold' so as to amount to absolute discharge. See *Currie v Misa* (1875) LR 10 Ex 153 at 164. See also *The Guardians of the Poor of the Lichtfield Union v Greene* (1857) 26 LJ Ex. 140 at 142. At the same time, while being legal tender under s 6 of the Bank of England Act 1833 (UK), 3 & 4 Will. 4, c. 98, actual convertibility to specie 'had been an essential feature of the Bank of England Act 1833.' Proctor, above n 14 at 65.

<sup>47</sup> eg one dollar for 100 pennies (each of one cent), 20 nickels (each of five cents), 10 dimes (each of 10 cents), or four quarters (each of 25 cents).

<sup>48</sup> See Sargent and Velde, above n 43 at 5 (as well as Preface at xvii), specifically drawing on CM Cipolla, *Money, Prices, and Civilization in the Mediterranean World, Fifth to Seventeenth Century* (New York: Gordian Press, 1967, originally published by Princeton University Press in 1956) at 27. The triumph of the standard formula in the course of the nineteenth century is set out by Sargent and Velde, above n 43 at 306–19.

<sup>49</sup> That is, 100 pennies, 20 nickels, 10 dimes, or four quarters are convertible to one dollar. Two nickels are converted to a dime, etc. Each such conversion is irrespective of the metallic content of the sub-unit denominations (that is, the penny, nickel, dime, or quarter). The 'standard formula' preceded the cessation of convertibility (discussed in the next paragraph); yet, as it is understood today, the 'standard formula' does not rule out (nor does it require) that the basic unit, eg the dollar, be convertible or at least anchored to the value of a specified quantity of a given precious metal.

<sup>50</sup> In England, abolition of convertibility goes back to the *Gold Standard Act* 1925 (UK), 15 & 16 Geo. 5, c. 29. Abolition was strengthened in the *Gold Standard (Amendment) Act*, 1931 (UK), 21 & 22 Geo. 5, c. 46. See Holden, above n 39 at 279.

<sup>51</sup> For terminology, see explanation in n 43 above.



ond half of the twentieth century, even the measurement of the unit of account by reference to a specified quantity of a given precious metal was abolished.<sup>52</sup> The external value of the standard national unit of value is now determined only by reference to the value in which that national unit of value is traded in international financial markets by reference to each other national unit of accounts.

Over the years, as an alternative to payment in money, various methods have developed for making payment by means of obligations to pay, thereby bypassing the physical delivery of coins and banknotes, and the inconveniences and risks associated with them. The present study examines the origins and early development of such methods of payment by means of obligations to pay and the legal doctrines governing their operations.

As part of the evolution of payment methods other than the delivery of coins and banknotes, the concept of what constitutes money has been expanded.<sup>53</sup> In effect, as a means of payment, 'money' in its concrete form, physically delivered, has converged with 'monetary value' transmitted by means of a payment mechanism. Indeed, the modern payment system has been described as 'a complex set of arrangements involving such diverse institutions' as banknotes and coins, the banking system, clearing houses, and the central bank.<sup>54</sup>

In this setting, it is the central bank that issues banknotes. At the same time, it is the banking system, with the central bank at its head, which serves as the backbone of the non-cash payment system.<sup>55</sup> The latter is described as 'an inverted pyramid',<sup>56</sup> with 'the broad base of economic actors whose daily activity in the market economy gives rise to payment obligations',<sup>57</sup> made through banks, 'with the central bank at the apex'.<sup>58</sup> Thus, the central bank operates in

<sup>52</sup> The 'cutoff' date is 15 August 1971. On that day the US ceased to maintain the purchasing power of the US dollar in terms of a specified amount of gold. Thereby it effectively abolished the gold (or any other commodity) standard as the yardstick for the international monetary system. Until then, all currencies had been measured by reference to the US dollar, which in turn, had been assessed in gold. See Lastra, above n 44 at 362–63.

<sup>53</sup> See above text and nn 11–15. Not everybody agrees that this is a positive development. See eg K Sono, 'The changing role of currency – towards a catastrophe or a new system?' (1995), 38 *Japanese Annual of International Law* 83. According to this author, the new attitude towards money, caused by changes in payment methods, is one of the 'troublesome aspects of the present international monetary order' (at 84).

<sup>54</sup> MS Goodfriend, 'Money, Credit, Banking, and Payment System Policy', in DB Humphrey (ed), *The US Payment System: Efficiency, Risk and the Role of the Federal Reserve* (Boston: Kluwer Academic Publishers, 1990) 247, at 247. He also mentions deposit insurance, which may be less indispensable, but whose role is nevertheless mentioned in ch 10, section 5 below.

<sup>55</sup> The central bank's role is compromised in monetary systems in which the amount of currency in circulation together with banks' balances in reserve accounts is backed by 100% foreign currency. This is the case in a national payment system either in foreign currency or in currency issued by a local currency board. For the latter see eg SK Tsang, 'Legal Frameworks of Currency Board Regimes', (August 1999) *Hong Kong Monetary Authority Quarterly Bulletin* 50.

<sup>56</sup> EG Corrigan, 'Luncheon Address: Perspectives on Payment System Risk Reduction', in DB Humphrey (ed), above n 54, at 129, 130.

<sup>57</sup> HI Blommestein and BJ Summers, 'Banking and the Payment System', in BJ Summers (ed), *The Payment System – Design, Management and Supervision* (Washington: International Monetary Fund, 1994) 15 at 27.

<sup>58</sup> BJ Summers, 'The Payment System in a Market Economy', in BJ Summers, *ibid* at 1, 5.

the payment system primarily within its double role as (i) the issuer of banknotes, and sometime coins, denominated in the national currency,<sup>59</sup> as well as (ii) the bankers' bank holding settlement or reserve accounts for them.<sup>60</sup>

Typically, a non-cash payment transaction between a payer and a payee presupposes both to have accounts with financial institutions, usually deposit-taking institutions, collectively referred to in this study as 'banks' (or 'commercial banks'). It is initiated by a payment order instructing payment. Payment orders could be written or issued electronically; they can further be processed manually or in automated systems. For such payment orders, where the payer and payee have accounts in different banks, interbank clearing is required; it takes place in clearing houses, or otherwise over clearing facilities, and is followed by interbank settlement, which between two domestic large banks is typically carried out over the books of the domestic central bank. The architecture of the modern payment system is thus premised on customers, linked to banks, which in turn are linked to a central bank, with funds moving across bank accounts by means of customers' payment orders. Payment orders could be transmitted in various media, and fall into diverse categories of payment mechanisms, such as paper cheques, wires (cables), or electronic messages initiated by the insertion of cards.

It is in this context that the narrow 'monetary base' of a country is said to consist of the obligations of its central bank, both on banknotes it issues, and on deposits it holds for commercial banks in their settlement (or reserve) accounts ('central-bank money'). The broader 'money-supply' in the hands of the public is taken to consist of such banknotes issued by the central bank (plus coins for small change issued either by the central bank or a government agency), together with demand deposits, held by the public in commercial

<sup>59</sup> The national currency is the unit of account in which prices are set and whose value is guarded by the central bank. Typically, such banknotes and coins are 'legal tender', in which a debtor may pay and which a creditor must accept in discharge of private and public debts. 'Currency' and 'national currency' are defined (albeit incompletely) eg in BA Garner (ed in chief), *Black's Law Dictionary*, 9th edn (St Paul MN: West, 2009) at 440, 979. For more satisfactory definitions of 'legal tender' visit [www.merriam-webster.com/dictionary/legal%20tender](http://www.merriam-webster.com/dictionary/legal%20tender) or [www.en.wikipedia.org/wiki/Legal\\_tender#cite\\_note-0](http://www.en.wikipedia.org/wiki/Legal_tender#cite_note-0).

<sup>60</sup> 'Defining central banking is problematic. In one sense we recognise it when we see it.' See F Capie, C Goodhart and N Schnadt, 'The Development of Central Banking', in F Capie, C Goodhart, S Fischer and N Schnadt, *The Future of Central Banking – The Tercentenary Symposium of the Bank of England* (Cambridge: Cambridge University Press, 1994) 1 at 5. Briefly stated, the central bank is the issuer of the national currency and guardian of its value. As a bank, its main clients are the government (for which it acts as a financial agent) and commercial banks. For the latter it also acts as a lender of last resort. With respect to the financial and payment systems, it is charged with oversight, and may be assigned regulatory powers. Additional tasks may relate to management of debt and foreign exchange reserves as well as exchange controls. See in general, RM Lastra, *Central Banking and Banking Regulation* (London: Financial Market Group, 1996) at 250–86 (Appendix: 'Evolution of the Functions of a Central Bank: A Rationale of Central Banking'). See also: JA Spindler and BJ Summers, 'The Central Bank and the Payment System', in Summers, above n 57 at 164, and M Manning, E Nier and J Schanz (eds), *The Economics of Large-value Payments and Settlement: Theory and Policy Issues for Central Banks* (Oxford: Oxford University Press, 2009) at 137–203 (Part III: Public-policy intervention in payment and settlement systems).

banks. 'Monetary value' deposited with banks is also known as 'funds', 'bank money', or more specifically, to distinguish it from money held with the central bank, 'commercial bank money'. Consisting of cash and bank deposits, the 'money supply' reflects the total purchasing power of a given society, and as such, is premised on the convergence between 'money' as cash and 'monetary value' as 'money' on deposit.<sup>61</sup> At the same time, as indicated in the introduction to this chapter, while payment in money entails the physical delivery of banknotes and coins, the payment in 'monetary value' is necessarily by means of a 'payment mechanism'. It is to that end that the juxtaposition between 'money' and 'monetary value' is helpful for the purpose of this chapter.

### 3. PAYMENT IN MONEY

#### 3.1 The Meaning of 'Payment'

'Payment' is broadly defined to mean 'any act offered and accepted in performance of a money obligation.'<sup>62</sup> On their part, '[m]onetary obligations primarily exist, where the debtor is bound to pay a fixed, certain specific, or liquidated sum of money'.<sup>63</sup> 'Payment' thus signifies the '[p]erformance of an obligation by the delivery of money or some other valuable thing accepted in partial or full discharge of the obligation'.<sup>64</sup> Specifically, it is 'a transfer of money from one person (the payer) to another (the payee)'.<sup>65</sup> When made in pursuance of a debt or obligation it is sometimes called payment in satisfaction.<sup>66</sup>

'Payment' may be carried out by the physical delivery of cash, that is, currency, consisting of banknotes and coins. Typically, each country designates banknotes and coins, usually denominated in its own national currency, as 'legal tender';<sup>67</sup> the latter is money that, at least in the absence of an agreement to the contrary, a debtor may offer and the creditor must accept in discharge of a

<sup>61</sup> See text and n 11 above.

<sup>62</sup> RM Goode, *Payment Obligations in Commercial and Financial Transactions* (London: Sweet & Maxwell, 1983) at 11 (hereafter: Goode, *Payment Obligations*).

<sup>63</sup> Proctor, above n 14 at 87 (para 3.03).

<sup>64</sup> BA Garner (ed in chief), *Black's Law Dictionary*, above n 59 at 1243.

<sup>65</sup> There is no such thing as 'a man paying himself.' See *Faulkner v Lowe* (1848) 2 Ex. 595 at 597, 154 E.R. 628 at 630, per Pollock C (in argument). Hence, '[p]ayment, necessarily implies two distinct persons.' JS James, *Stroud's Judicial Dictionary of Words and Phrases*, 5th edn (London: Sweet & Maxwell, 1977) vol 4 at 1337.

<sup>66</sup> *Jowitt's Dictionary of English Law*, above n 38 at 1337. Needless to say, 'payment' can also be made by way of gift except that this is the less usual situation.

<sup>67</sup> Eg, the general principle under s 8(1) of the *Canadian Currency Act* R.S.C. 1985, c. C-52, is that 'a tender of payment of money is a legal tender if it is made (a) in coins that are current under Section 7 [generally meaning 'issued under the authority of . . . the *Royal Canadian Mint Act*']; and (b) in notes issued by the Bank of Canada pursuant to the *Bank of Canada Act* intended for circulation in Canada.'

debt.<sup>68</sup> However, ‘money . . . is not necessarily legal tender’;<sup>69</sup> parties may agree on payment in foreign currency.<sup>70</sup> They may also agree on payment by means of a non-cash payment mechanism.<sup>71</sup> Payment in foreign currency may be agreed to be executed either in cash or by means of a non-cash payment mechanism.

The present discussion is on payment in fact, that is, the ‘actual payment from the payer to the payee’;<sup>72</sup> in the discharge of a debt. This section is concerned exclusively with payment as a transfer of money in the form of the delivery of cash, whether in domestic or foreign currency, and whether in legal tender or not. Payment by means of a non-cash payment mechanism initiated by an order to pay money is the subject-matter of the concluding section (section 4) of this chapter.

### 3.2 Tender of Money

‘Payment’ is quite different from ‘tender of money’. In *Dixon v Clark* (1848),<sup>73</sup> Wilde CJ explained that ‘the principle of the plea of tender’ is a matter of defence to an action for a debt. As such it means that:

[T]he defendant has been always ready . . . to perform entirely the contract on which the action is founded; and that he did perform it, as far as he was able, by tendering the requisite money; the plaintiff himself precluded a complete performance, by refusing to receive it. And, as, in ordinary cases, the debt is not discharged by such tender and refusal, the plea must not only go on to allege that the defendant is still ready . . . , but must be accompanied by [an offer in court] of the money tendered. If the defendant can maintain this plea, although he will not thereby bar the debt . . . , yet he will answer the action<sup>74</sup>

Tender is an ‘attempted performance’, denoting a stage where the debtor has done everything which does not require the creditor’s cooperation towards per-

<sup>68</sup> Cf *Black’s Law Dictionary*, above n 59 at 979 defining ‘legal tender’ as ‘[t]he money (bills and coins) approved in a country for the payment of debts, the purchase of goods and other exchanges for value.’

<sup>69</sup> *Re Alberta Legislation* [1938] 2 D.L.R. 81 at 92 (SCC), aff’d *sub nom AG Alta v AG Can* [1939] A.C. 117 (P.C.).

<sup>70</sup> Foreign money obligations are discussed by Goode, *Payment Obligations*, above n 62 at 121–45. For foreign currency (from the seller’s perspective) as the money of payment for a debt denominated in the domestic currency, see *Woodhouse AC Israel Cocoa Ltd SA v Nigerian Produce Marketing Co Ltd* [1971] 2 Q.B. 23, aff’d [1972] A.C. 741. A leading case on the enforcement of an obligation payable in foreign currency is *Miliangos v George Frank (Textile) Ltd* [1976] A.C. 443 (H.L.).

<sup>71</sup> It is, however, possible nowadays, for either fiscal or anti-crime reasons, to have cases where it is required that certain payments, usually above a specified ceiling, are to be carried out by means of a payment mechanism and not in cash.

<sup>72</sup> *Jowitt’s Dictionary of English Law*, above n 38 at 1337. In contrast, ‘payment in law’, that is ‘a transaction equivalent to actual payment’ (*ibid*), is outside the scope of the present discussion.

<sup>73</sup> (1848) 5 C.B. 365, 136 E.R. 919 (C.P.).

<sup>74</sup> *Ibid* at C.B. 377, E.R. 923–24.

formance.<sup>75</sup> To make a successful tender plea, the defendant-debtor must show that 'the plaintiff [creditor] himself precluded a *complete performance* by refusing to receive it' (emphasis added).<sup>76</sup> An unaccepted tender is an answer to an action alleging breach by non-performance of the payment obligation;<sup>77</sup> it precludes the non-accepting creditor from bringing an action against the tendering debtor for damages caused by the breach of the payment obligation.<sup>78</sup> 'Tender' is, however, not as good of a plea as 'payment', which discharges the debt.<sup>79</sup>

A plea of tender must be supported by 'an offer of the specific sum due, unqualified by any circumstance whatever.'<sup>80</sup> Nevertheless, a bare offer does not suffice. It is not enough for the debtor to say that 'he had [the money] in his pocket.'<sup>81</sup> Rather, an effective tender is 'an offer to pay, by producing the money.'<sup>82</sup> 'Production' means 'exhibition'. Thus, where the debtor offered payment, 'then put his hand into his pocket, but before he could take out the money the [creditor] left the room', the plea of tender failed.<sup>83</sup> On the other hand, it was a sufficient tender where the debtor had the money twisted up in his hand, although not exposed, and he stated the amount offered.<sup>84</sup>

There is some ambiguity as to the adequacy of production of money in bags. This can be traced to *Sucklinge v Coney* (1598).<sup>85</sup> In that case:

<sup>75</sup> Cf AV Levontin, 'Debt and Contract in the Common Law' (1966), 1 *Israel Law Review* 60 at 91, fn 148 where 'tender' is explained as being 'as much performance as lies in the debtor's hands.'

<sup>76</sup> *Ibid.*

<sup>77</sup> See eg *Giles v Hartis* (1698) 1 Ld. Raym. 254 at 254, 91 E.R. 1066, at 1066 (K.B.) per Holt CJ: '[t]hough a tender is made, and the plaintiff refuses the money, yet the tender cannot be pleaded in bar of the action, neither in debt nor assumpsit but *in bar of the damages only*, for the debtor shall nevertheless pay his debt.' (Emphasis added.)

<sup>78</sup> See eg *Lancashire v Killingworth* (1700), 1 Ld. Raym. 686, 91 E.R. 1357 (K.B.). This may be the source of the linguistic confusion.

<sup>79</sup> See also *New Brunswick Railway Co v British and French Trust Corp Ltd* [1939] A.C. 1 at 23, per Lord Maugham LC (H.L.).

<sup>80</sup> *Brady v Jones* (1823) 2 Dow. & Ry. 305, 306–07 quoted in note (c) to *Wade's Case* (1601) 5 Co. Rep. 114 a at 115 a, 77 E.R. 232 at 234 (C.P.). At the same time, 'a tender of the greater includes the smaller sum', see *Douglas v Patrick* (1790) 3 T.R. 683 at 685, 100 E.R. 802 at 803, per Ashhurst J (K.B.). See also *Dean v James* (1833) 4 B. & AD. 546, 110 E.R. 561 (K.B.). However, the tender of a larger sum requiring change may not be a good tender of the smaller sum. See *Robinson v Cook* (1815) 6 Taunt. 336, 128 E.R. 1064 (C.P.). But 'if the debtor tenders a larger sum of money than is due, and asks for change, this will be a good tender, if the creditor does not object to it on that account, but only demands a larger sum.' See *Black v Smith* (1791) Peake 121 at 122, 170 E.R. 101 at 101, per Lord Kenyon (Lilly Assize). For the requisites of tender see Annotation (1912) 1 D.L.R. 666.

<sup>81</sup> As it was in *Douglas v Patrick*, *ibid* at T.R. 684, E.R. 803.

<sup>82</sup> *Dickinson v Shee* (1801) 4 Esp. 67 at 68, 170 E.R. 644 at 644, per Lord Kenyon (Lilly Assizes). See further *Dickinson v Shee*, *ibid*; 'there should . . . be an offer to pay, by producing the money, unless the [creditor] dispensed with the tender expressly, by saying, that the [debtor] need not produce the money, as he would not accept it' (quoted with approval in *Thomas v Evans* (1808) 10 East 101 at 103, 103 E.R. 714 at 714–15 per Bayley J. See also *Douglas v Patrick*, *ibid*, *Thomas v Evans*, *ibid*; *Finch v Brook* (1834), 1 Bing. (N.C.) 253, 131 E.R. 1114 (C.P.); *Ex parte Danks. In the Matter of Farley* (1852) 2 De G. M. & G. 936, 42 E.R. 1138 (Ch.). *Farquharson v Pearl Assurance Co Ltd* [1937] 3 All E.R. 124 at 130–31 (K.B.).

<sup>83</sup> *Leatherdale v Sweepstone* (1828) 3 Car. & P. 342 at 343, 172 E.R. 448 at 448 (N.P.).

<sup>84</sup> *Alexander v Brown* (1824) 1 Car. & P. 288, 171 E.R. 1199 (N.P.).

<sup>85</sup> (1598) Noy 74, 74 E.R. 1041 (K.B.).

[U]pon payment for a redemption of a mortgage, the mortgager comes at the day and place of payment, and said to the said mortgagee, Here I am ready to pay you the 200l. which was of due money, and yet held it all time upon his arms in baggs. And adjudg'd no tender; for it might be counters or base [coin] for anything appeared.

Denial of the tender plea appears to rest on the fact that the payee was deprived of the opportunity to examine the money and satisfy himself that it was genuine. However, in the particular circumstances of the case, this rationale can be viewed as premised on the fact that the debtor 'held [the money] all times upon his arms', that is, he did not actually produce it. Alternatively, the decision may be attributed to the fact that at 'all times' the money was kept in bags so that the creditor could not see it. It is not clear from the report whether the production of money in bags, in circumstances which allow the payee to open the bags and examine the money, is a sufficient tender.

Some cases specifically required that 'the money should be actually shewn to the person to whom it is tendered.'<sup>86</sup> Other cases, such as *Wade's Case* (1601),<sup>87</sup> resolved that 'where the plaintiff did tender all the [sum due] in bags without shewing it or counting it . . . the tender was good, if the truth was that there [was the sum due].'<sup>88</sup>

Arguably, production of money in bags is adequate where the creditor is given, then and there, the opportunity to see and examine the money. Thus, money is not properly tendered 'when locked up in a box, so that the party to whom it is shewn cannot open it or see the contents.'<sup>89</sup> It follows that production of money is the exhibition of either the money itself or a bag containing it, while allowing the creditor to examine the money.

In whatever manner it is produced, money must be tendered on the due day at 'a convenient time' so that it 'may be counted before sun-set.'<sup>90</sup> Accordingly, 'it is not sufficient to state that [the debtor] was [at the designated place] at and shortly before the setting of the sun: he ought to have pleaded he was there long enough before to have counted the money.'<sup>91</sup> Those who are satisfied with the production of money in bags as an adequate tender, are unambiguous in allocating the counting responsibility on the payee:

The [debtor] may tender the money in [purses] or bagges, without [shewing] or telling the [same], for he doth that which he ought, viz. to bring the money in [purses] or bagges, which is the [usual] manner to carry money in, and then it is the part of the party that is to receive it to put it out and tell it.<sup>92</sup>

<sup>86</sup> *Douglas v Patrick*, above n 80, at T.R. 684, E.R. 803, per Ashhurst J.

<sup>87</sup> Above n 80.

<sup>88</sup> *Ibid* Co. Rep. 115a, E.R. 234.

<sup>89</sup> *Isherwood v Whitmore* (1842), 10 M. & W. 756 at 764, 152 E.R. 677 at 681, per Parke B (Ex.).

<sup>90</sup> *Wade's Case*, above n 80, at Co. Rep. 114a, E.R. 233. Modern authorities moved the deadline to midnight, though subject to the creditor's power to frustrate tender made not in a reasonable hour by not being available then. See *Afovos Shipping Co SA v Pagnan, The Afovos* [1982] 3 All E.R. 18 at 23, 26 (C.A.) and authorities cited there.

<sup>91</sup> *Tinckler v Prentice* (1812) 4 Taunt. 549 at 554, 128 E.R. 445 at 447 per Gibbs J (C.P.).

<sup>92</sup> E Coke, *First Part of the Institutes of the Laws of England; or a Commentary Upon Littleton* 15th edn by F Hargrave and C Butler (London: printed for E and R Brooke, 1794) vol 2, Sect 336, 208a.

In case of a mistaken overpayment, the payee is in principle liable in restitution to pay back the excess amount<sup>93</sup> proven by the payer. Usually the payee's failure to count in the payer's presence and to his satisfaction results in the loss of evidence but not in the forfeiture of the payer's rights.<sup>94</sup> The payee's position in case of underpayment is less clear. The question arises where tendered bags of money are accepted without objection, and upon subsequent examination of the money the payee finds a deficiency due either to a shortfall in the amount tendered, or to the tender of counterfeit money. The lack of clarity can be traced to the following passage from *Wade's Case* (1601):<sup>95</sup>

That where the [debtor] did tender all the 250*l.* in bags without shewing it, or counting it; it was resolved that the tender was good, if the truth was that there were 250*l.* in the bags . . . ; for when the condition is, that he shall pay 250*l.* the mortgagor doth all that is requisite by the law for him to do, if he provides the money, and offers it to the mortgagee in bags, which is the usual manner to carry money. And then it is the part of the mortgagee to count it if he will, or if he will credit the mortgager he may accept it without telling it; then if the telling it belongs to the mortgagee, by consequence he ought to put it out of the bags, which is incident to it, for without so doing he cannot tell it: and if the mortgagor puts the money out of the bags, yet it is at the peril of the mortgagee to look upon it, for perhaps they may be counterfeits, and yet have a great shew of good and lawful money, and also it is at his peril to count it: and if a man be bound to pay 40,000*l.* at such a day, if he tenders it in bags it is sufficient, for it cannot be counted in one day . . . And it was said that it was adjudged . . . , that where the lessor demanded rent of his lessee according to the condition of re-entry, and the lessee paid the rent to the lessor, and he received it, and put it in his purse, and afterwards looking it over again at the same time, he found amongst the money that he had received some counterfeit pieces, and thereupon he refused to carry away the money, but re-entered for the condition broken: and it was adjudged that the entry was not lawful; for when the lessor had accepted the money, it was at his peril, and after that allowance he shall not take exception to any part of it.

Prima facie, this allocates the risk of any subsequently discovered shortfall, whether due to counting or to counterfeits, to the payee. Nevertheless, the passage acknowledges explicitly that a large sum 'cannot be counted in one day.' Furthermore, a note appended to the report attempts to narrow the circumstances

<sup>93</sup> A case, primarily concerned with the position of an overpaid agent-payee is *ANZ Banking Group Ltd v Westpac Banking Corp* (1988) 78 A.L.R. 157 (Aust. H.C.).

<sup>94</sup> But see *Bank of Nova Scotia v Wu*, unreported, District Court of Ontario, judgment: 23 June 1987, Lissaman DCJ. The plaintiff-bank sued its customer for the recovery of an alleged excess amount of foreign currency funds withdrawn by him at a branch. The defendant-customer denied receiving any excess and alleged to have counted the money upon receipt. The case 'turn[ed] on the credibility of the witnesses.' The judge found the customer's evidence 'to be untruthful' and held for the bank. Acknowledging that the teller's performance 'was little short of incredible as far as negligence was concerned' and that the teller 'breached every [pertinent] regulation', the judge was nevertheless satisfied that the teller received the excessive amount from the foreign exchange cage and that 'none of this money was lost or stolen from the time it left the remittance cage with [the teller] and to the time it was given by [him] to [defendant-customer].' See paras 35–36 of the reasons for judgment.

<sup>95</sup> Above n 80 at Co. Rep. 115a, E.R. 234.



under which the payee assumes responsibility for subsequently discovered counterfeit money:

Although such an acceptance [of the money by the lessor] may be good, to prevent the party accepting, from taking advantage of the condition, yet it may be doubted, whether a payment in bad money can be taken to be a good payment to all intents.<sup>96</sup>

Finally, the passage states that the lessor not only ‘received’ but also ‘accepted’ the money. That is, the case may be understood as merely penalizing a non-diligent payee who could have found the deficiency by counting and examining the money as it had been tendered, prior to accepting it.<sup>97</sup> At the same time, under this interpretation, a diligent payee who could not have caught the deficiency upon delivery, either because of the large amount to be counted, or because a reasonable examination on delivery would not have spotted counterfeits,<sup>98</sup> is not penalized.

This passage from *Wade’s Case* (1601) has not been permitted to shield a fraudulent payer.<sup>99</sup> Beyond that, the scope of the rule has not been ascertained in England.<sup>100</sup>

A broad rule allocating the risk of shortfall on the payee was rationalized in the United States in *Atwood v Cornwall* (1873).<sup>101</sup> The rule was, however, stated to be limited to circumstances in which the payee was not diligent in discovering and notifying the payer of the deficiency; the rule was thus stated to be premised ‘on the ground . . . that parties in equal equity shall not be disturbed.’<sup>102</sup> The judicial consensus that evolved in the United States distinguished the passage from *Wade’s Case* (1601) in two ways. First, in line with the note appended to the judgment,<sup>103</sup> the passage was understood as relating to the performance of the condition, but not to payment.<sup>104</sup> Second, as indicated, payment in bad

<sup>96</sup> *Ibid* n E.

<sup>97</sup> See C Viner, *A General Abridgment of Law and Equity* (Aldershot: Printed for the Author, 1741), vol 20, ‘Tender’ (E) at 183 where a note explains *Wade’s Case* as holding that ‘if there is any bad money in the bags, and the mortgagee accepts it, the mortgager is not bound to change it’ (emphasis in original). The note goes on to explain the judgment as referring to a payee ‘who put the money into his purse [purse] and after he took it out and told it over again, and found counterfeit pieces’.

<sup>98</sup> Indeed, not only ‘those who are constantly handling money . . . [but rather] all persons are supposed to have some . . . knowledge [of currency], sufficient to enable them to do business with ordinary security.’ See *Atwood v Cornwall* (1873) 28 Mich. 336 at 340 (Mich. S.C.). Nevertheless, notwithstanding diligence, counterfeit foreign currency as well as skillfully forged domestic money may be hard to spot by ordinary means on delivery.

<sup>99</sup> See eg W Sheppard, *Sheppard’s Touchstone of Common Assurances*, 7th edn (by E Hilliard and R Preston) (London: J & WT Clarke, 1820) at 136, fn 49. See also *Phelan v Dalson* (1853) 14 Ark. 79; and *Wingate v Neidlinger* (1875) 50 Ind. 520 at 526 (S.C., Ind.).

<sup>100</sup> But cf *Jones v Ryde* (1814) 3 Taunt 488 at 494, 128 E.R. 779 at 782, (K.B.) where Heath J stated that ‘[i]f a person gives a forged bank note, there is nothing for the money: it is no payment,’ thereby overlooking *Wade’s Case* altogether.

<sup>101</sup> Above at n 98.

<sup>102</sup> *Ibid* at 342.

<sup>103</sup> Text above n 96.

<sup>104</sup> See eg *Young v Adams* (1810) 6 Mass. 181 at 186, (S.C., Mass.) cited with approval in *Curcier v Pennock* (1826) 14 Serg. & R. (S.C., Pa.) 51 at 61–62 (Pa. Side Reports); see also *Hargrave v Dusenbury* (1823) 9 N.C. 326 (S.C., N.C.).



money was to be regarded as effective only against a non-diligent payee.<sup>105</sup> Accordingly, the passage from *Wade's Case* did not bar recovery by a diligent payee.

According to the Supreme Court of the United States in *Bank of US v Bank of Georgia* (1825),<sup>106</sup> payment in bad money is a deficient performance of the payment obligation which does not discharge the debt. As such:

[A] payment received in forged paper, or in any base coin, is not good; and . . . if there be no negligence in the [payee], he may recover back the consideration paid for them, or sue upon the original demand.<sup>107</sup>

The diligence requirement is designed to enhance the payer's chances to trace the bad money back to its sources.<sup>108</sup> Diligence is further rationalized as a means to prevent the circulation of counterfeit money.<sup>109</sup> As for its scope, diligence must relate to the discovery as well as to the speedy return of counterfeit money.<sup>110</sup> The time frame for fulfilling the diligence requirement depends on the special circumstances of each case.<sup>111</sup>

The payer's liability to the diligent payee for the amount of bad money was theorized by American courts as either in *assumpsit*, specifically in money had and received,<sup>112</sup> or on an implied warranty as to the genuineness of the money.<sup>113</sup> Inasmuch as the former theory is premised on rescission for mistake,<sup>114</sup> it fails to explain why the loss caused by a common mistake falls necessarily on the payer.

The latter theory, based on warranty, is thus more satisfactory. The pertinent warranty was believed to be a by-product of the mere obligation to pay in currency of a specified description. Thus, in *Rasst v Morris* (1919),<sup>115</sup> the court was quite categorical in stating that under an obligation to pay in Mexican currency, 'the Mexican currency to be paid . . . [must] be genuine; for, if it was not genuine, it was not such currency' (emphasis added).<sup>116</sup> As further explained in

<sup>105</sup> See eg *Rasst v Morris* (1919) 108 A. 787 (S.C., Md.) and cases cited in nn 106–11 below.

<sup>106</sup> (1825) 10 Wheat 333, 23 U.S.R. 333 (U.S.S.C.). However, the rule which follows in the text was held in that case to be subject to an exception, applicable in that case itself, where the counterfeit notes purported to have been issued by the same bank to which they were paid.

<sup>107</sup> *Ibid* at 342. See also *Kenny v First National Bank of Albany* (1867) 50 Barb. 112 (S.C., N.Y.); and *Wingate v Neidlinger*, above n 99 at 522.

<sup>108</sup> See eg *Simms v Clark* (1849) 11 Ill. 137 at 141 (S.C., Ill.); *Atwood v Cornwall*, above n 98 at 341.

<sup>109</sup> *Atwood v Cornwall*, *ibid* at 342; *Wingate v Neidlinger*, above n 99 at 526.

<sup>110</sup> *Kenny v First National Bank of Albany*, above n 107.

<sup>111</sup> For this principle see *Simms v Clark*, above n 108, at 141. Decided cases include *Raymond v Baar* (1825) 13 Serg. & R. (S.C. Pa.) 317 (Pa. Side Reports); *Wingate v Neidlinger*, above n 99; *Curcier v Pennock*, above n 104; and *Atwood v Cornwall*, above n 98.

<sup>112</sup> See eg *Young v Adams*, above n 104; and *Mudd v Reeves* (1883) 2 H. & J. 368 (S.C., Md.).

<sup>113</sup> But cf *Atwood v Cornwall*, above n 98, which is somewhat unclear on this point.

<sup>114</sup> See RA Lord, *Williston on Contracts*, 4th edn (Minnesota: Thomson West, 2003) at §70:186. See also A Nussbaum, *Money in the Law National and International: A Comparative Study in the Borderline of Law and Economics*, rev edn (Brooklyn: The Foundation Press, Inc, 1950) at 97, fn 20.

<sup>115</sup> Above n 105.

<sup>116</sup> *Ibid* at 792.

*Curcier v Pennock* (1826),<sup>117</sup> '[t]he reason why payment in money which is counterfeit . . . does not discharge the debt, is that the [payee] has not got the *thing* for which he bargained' (emphasis added).<sup>118</sup> In more general terms, every payment obligation in articles serving as a medium of payment in a foreign country contains an implied warranty. Under that warranty, the payee has 'a right to expect a passable article, answering the description of [the foreign] money – a thing that would pass in the [foreign] market as money.'<sup>119</sup>

### 3.3 The Process of Payment: Completion, Risk and Remedies

The process of payment in cash can be analogized to the process under which property passes under a sale of unascertained goods by description; in the latter case, under the law that governs the sale of goods, property passes to the buyer when goods meeting the contract description 'are unconditionally appropriated to the contract . . . by the seller with the assent of the buyer'.<sup>120</sup> Similarly, payment in cash typically begins by the payer's selection, or 'ascertainment' of the specific coins or banknotes to be handed over to the payee.<sup>121</sup> It continues with the payer's 'unconditional appropriation' in the form of tender of delivery, and culminates in the payee's 'assent' upon the delivery of the money.<sup>122</sup> Payment is thus 'a bilateral act which requires the [payee] to accept the [payer]'s act of

<sup>117</sup> Above n 104.

<sup>118</sup> *Ibid* at 56. On the other hand, '[t]he gum of the kingdom of *Senegal* is its only currency; yet, with us, it enters into the transaction of commerce exclusively as a commodity; and no one will doubt, that payment in gum not merchantable would, even in *Senegal*, discharge the debt; and so would payment in tobacco have done, while it was the circulating medium of *Maryland* and *Virginia*', *ibid*, emphasis added.

<sup>119</sup> *Ibid* at 58.

<sup>120</sup> The quoted language is from s 18, r 5(1) of the *Sale of Goods Act* 1979 (UK), 1979, c. 54. The provision further requires that appropriated goods will be 'in a deliverable state' and permits the alternative of appropriation by the buyer with the assent of the seller.

<sup>121</sup> In connection with the sale of goods, 'ascertained' was held to mean that 'the individuality of the goods must in some way be found out.' *Thames Sack and Bag Co Ltd v Knowles & Co Ltd* (1918) 88 L.J.K.B. 585, per Sankey J (K.B.); 119 L.T. 287. More specifically, 'ascertained' was held to 'probably mean . . . identified in accordance with the agreement after the time a contract for sale is made.' *In re Wait* [1927] 1 Ch. 606 at 630, per Atkin LJ (C.A.) (with some hesitation); adopted in *Re Western Canada Pulpwood and Lumber Co Ltd* [1929] 3 W.W.R. 544 at 548 (Man. C.A.) per Fullerton JA. Accordingly, Bridge concluded that in general, 'ascertainment occurs once goods have subsequently been identified to the contract.' MG Bridge, *The Sale of Goods*, 2nd edn (New York: Oxford University Press, 1997) at 75.

<sup>122</sup> Notwithstanding the observation of Sargant LJ in *In Re Blyth Shipbuilding and Dry Docks Co Ltd* [1926] Ch. 494 at 518 (C.A.), according to which "'appropriated" is a term of legal art and has a certain definite meaning', 'appropriation' is a less definite term. Its ambiguity was acknowledged in *Wait v Barker* (1848) 2 Ex. 1 at 8–9; 154 E.R. 380 at 383–84. Perhaps, and notwithstanding *Caradoc Nurseries Ltd v Marsh* (1959) 19 D.L.R. (2d) 491 (Ont. C.A.) – where the seller's appropriation was viewed as an irrevocable election, capable by itself of passing property – 'appropriation' can be viewed as a form manifestation of the selection, something that amounts to an offer, that when accepted binds the offeror, but nevertheless, can be revoked until accepted.

tender';<sup>123</sup> payment is made on the passage of possession in the money<sup>124</sup> when the payee takes delivery, thereby manifesting the acceptance of the tender.<sup>125</sup> In this process, the payer and payee, respectively, are in the position of a seller and buyer of money as unascertained goods.

Depending on the circumstances, an examination and counting by the payee of money tendered to him is consistent with either previous or subsequent passage of property. Where it is mutually agreed that conformity with the correct amount is to be deferred to the completion of counting and examination, and counting and examination takes place either in the payer's presence, or in other circumstances which secure the segregation of the payer's money, passage of property is postponed until the ascertainment of the correct amount and the unconditional appropriation of specific coins and banknotes have been completed. Usually, however, parties intend to time the passage of property to the delivery stage. Hence, an examination and counting of money tendered, whether made upon delivery or diligently thereafter, is to be treated as occurring in the post payment stage, so as to facilitate the timely exercise of rejection rights, if necessary. Needless to say, a payee who examines and counts the money after delivery, and not in the payer's presence, may fail to establish diligence, and may also fail to put forward reliable evidence supporting the alleged shortfall. Similarly, a payer alleging a mistaken overpayment, who is entitled in principle to recover the excess from the payee, may face difficulties in proving his case after the payee took the money and left.

Usually, the loss of the right to reject a nonconforming tender of money results in the loss of the rights to sue the payer for damages for any shortfall. This is so for the following reasons. First, once money has been accepted and commingled, there is likely to be evidentiary difficulty in identifying the payment tendered by the payer. Second, lack of diligence which bars rejection is likely to constitute failure on the payee's part to mitigate the loss. However, inasmuch as the useful value of bad money is nil, there is no difference between the amount recovered upon the rejection of bad money, and the amount recovered in an action for damages for breach.

There is some direct authority confirming the preceding analysis as to the identification of the point of payment as well as to the existence of post-payment rejection rights. As will be seen below, pertinent cases were concerned with irreversibility and passage of risk.

*Chambers v Miller* (1862)<sup>126</sup> was an action for an assault and false imprisonment. The plaintiff presented a cheque for payment at the defendants' banking-house. The defendants were the drawees of the cheque. The plaintiff acted on behalf of his employer, the holder of the cheque. The defendants' cashier counted out the amount in notes, gold and silver, and placed it on the counter.

<sup>123</sup> Fox, above n 3 at 28.

<sup>124</sup> Hence, contract alone cannot transfer the legal title to money. Fox, *ibid* at 87.

<sup>125</sup> Fox, *ibid* at 79–86, and further, at 87–95.

<sup>126</sup> (1862) 13 C.B. (N.S.) 125, 143 E.R. 50 (C.P.).

The plaintiff took it and counted it. He was counting it the second time, when the cashier, who had discovered an overdraft in the drawer's chequing account, demanded the money back. Upon the plaintiff's refusal to return the money, the cashier detained him and took the money from him by force.

The decision was in favour of the plaintiff on the basis of the passage of property in the money upon the completion of payment. Erle CJ thought that '[t]he ordinary rule of law' under which 'property in a chattel passes according to the intention of the parties' applied also to a payment. In this case there was an appropriation of the money to be delivered to the plaintiff: '[The banker's clerk] counted out the notes and gold and placed them on the counter for the plaintiff to take up.' At this point, '[i]t no longer remained a matter of choice or discretion with [the former] whether he would pay the cheque or not.' In the facts of the case, '[t]he plaintiff had taken possession of the money, counted it once, and was in the act of counting again, when the clerk . . . claimed to revoke the act of payment which on his part was already complete'. Under those circumstances:

[T]he bankers had parted with the money, and the plaintiff had accepted it. It is true [the plaintiff] had not finished counting it, and that, if he had found a note too much or a note short, there was still time to rectify the mistake. But, according to the intention of the parties, and the course of business, the money had ceased to be the money of the bankers, and had become that of the party presenting the cheque.<sup>127</sup>

All other judges gave concurring judgments. Williams J thought that '[t]here was a complete and absolute transfer of the money':

It is said that the transaction was not complete, because the plaintiff had not finished counting the money, and therefore that he did not consider that the matter had come to an end. I cannot by any means assent to that. The recipient had a right to count the money, or he might if he pleased have taken it off the counter without counting it. I see no ground whatever for saying that the transaction was incomplete. There was no evidence that anything further remained to be done to complete it. The act of counting was no indication on the part of the plaintiff that he had not accepted the money.<sup>128</sup>

Byles J was 'inclined to hold, as a matter of law that, so soon as the money was laid upon the counter for the holder of the cheque to take it, it became the money of the latter.' As for the holder's right to object to a forged note included in the money delivered to him:

The only consequence would be that he would have a right to demand another note in place of it. His right to rescind the transaction so far would not prevent the property in the rest from vesting in him.<sup>129</sup>

Keating J held that 'the delivery of the money by the cashier to the holder of the cheque was complete, and that the property in it vested in the latter': 'The cashier

<sup>127</sup> *Ibid* C.B. 132–33, E.R. 53.

<sup>128</sup> *Ibid* C.B. 134, E.R. 53.

<sup>129</sup> *Ibid* C.B. 136, E.R. 54.

counted out the money, and placed it on the counter for the purpose and with the clear intention of putting it under the control of the person who presented the cheque.' Property would have passed if 'the plaintiff had been content to take up the money without stopping to count it.' 'It does not the less pass because the recipient chooses to count it before he puts it into his pocket.'<sup>130</sup>

Both Byles and Keating JJ held that inasmuch as 'payment' resulted in the passage of property to the money, there could not be any retraction of payment;<sup>131</sup> '[n]o case has ever yet held that a party has a right to re-take by force property which has already passed and vested in another.'<sup>132</sup>

In *Chambers v Miller* (1862), Williams J thought that:

If . . . after the money had been placed by the cashier upon the counter, and drawn towards him by the plaintiff, a thief had come in and stolen it whilst he was in the act of counting it, the loss would clearly have fallen upon the plaintiff, and the bankers would not have been under any obligation to pay the amount over again.<sup>133</sup>

The reverse situation involving the theft of money placed on the counter by a customer for payment to the bank was dealt with in *Balmoral Supermarket Ltd v Bank of New Zealand* (1974).<sup>134</sup> This was an action for the recovery of \$3,260 which the plaintiff claimed to have deposited in its bank account with the defendant bank. The plaintiff's employee attended the defendant's premises intending to deposit \$3,360 cash and some cheques. In the facts of the case:

[The plaintiff] emptied the cash from the canvas bag in which it had been contained onto the counter in front of the defendant's teller . . . The teller, on the other side of the counter, took a small bundle of notes from the money emptied onto the counter . . . and proceeded to count it. The rest of the money was left on the counter about midway between the plaintiff's employee and the teller where plaintiff's employee emptied it. When the teller had counted about \$100 in notes from the first bundle and had put them to one side intending to proceed with the counting of the rest of the money, two robbers entered the bank and took the pile of uncounted notes from the counter leaving . . . the \$100 already counted. It was alleged that there was \$3,260 in that pile.<sup>135</sup>

The question was who, as between the plaintiff-customer and the defendant-banker, had been robbed. That is, who had property in the \$3,260 cash at the time of the robbery?<sup>136</sup> Or stated otherwise, did the robbery take place prior to payment or thereafter? The plaintiff alleged that payment preceded the robbery. Its position was that 'when its employee placed the cash on the counter in front of the teller with the intention that the money should be banked',<sup>137</sup> there passed

<sup>130</sup> *Ibid* C.B. 137–38, E.R. 55.

<sup>131</sup> *Ibid* C.B. 136–37, E.R. 54, per Byles J.

<sup>132</sup> *Ibid* C.B. 138, E.R. 55, per Keating J.

<sup>133</sup> *Ibid* C.B. 135, E.R. 54.

<sup>134</sup> [1974] 2 N.Z.L.R. 155 (S.C.).

<sup>135</sup> *Ibid* at 156.

<sup>136</sup> For the deposit of money with a banker as transferring property in the money from the depositor to the banker, see ch 9, section 2 and ch 12, section 3 below.

<sup>137</sup> The verb 'bank' is used consistently in the judgment as the equivalent of 'deposit'.

to the bank both the possession of and property in that money so that the bank was then liable to account to the plaintiff although the money was in fact taken by the robbers. On the other hand, the defendant-bank 'denie[d] that the possession of or property in the money had passed.'<sup>138</sup> Alternatively, the bank submitted that it 'had the money under a bailment for the limited purpose of counting it and that property in an article bailed does not pass to the bailee.'<sup>139</sup>

In the course of his duties, a teller was required 'to count any notes presented by a customer for deposit and then to check the figures recorded on the banking sheet completed by the customer.' Then, '[i]f the figure on the banking sheet coincided with the counted money, the banking slip was . . . receipted and the customer's copy stamped in the same manner.'<sup>140</sup> In the case at bar, this process had not been completed. However, the plaintiff-depositor alleged, primarily on the basis of *Chambers v Miller* (1862),<sup>141</sup> that 'possession of and property in the money had passed to the bank upon it being placed in front of the teller for counting.'<sup>142</sup>

McMullin J treated 'legal possession' as determined by the amount of occupation or control capable of excluding others, accompanied by '*animus possidendi*.'<sup>143</sup> He explained *Chambers v Miller* (1862) on the basis of the fact that 'the banker's clerk had done all that was possible to pass the property in the money to the plaintiff'<sup>144</sup> and thus distinguished it from the case at bar:

In the present case there was never full legal possession of the money in the bank to the exclusion of the plaintiff. At any time before the money had been counted, and it may be until the banking slip had been receipted, the plaintiff's employee could have called for a return of the money placed on the counter<sup>145</sup>

Possession of the money on the counter could have been 'a joint factual possession shared with the plaintiff.' This fell short of the required 'legal possession' in the defendant's hands as occupation and control exercised by it did not exclude the plaintiff's employee from interfering. Furthermore, even if possession had passed to the bank, it did not follow that passage of ownership resulted:

Although property in currency generally passes with its possession, this is not necessarily so and the principle must remain that property in currency passes when it is intended by the parties that it shall pass.<sup>146</sup>

Accordingly, judgment was given for the defendant-bank.

*Chambers v Miller* (1862)<sup>147</sup> involved an appropriation on behalf of the paying banker and as assent given by the payee. In other words, there was a tender

<sup>138</sup> Above n 134 at 156.

<sup>139</sup> *Ibid* at 158.

<sup>140</sup> *Ibid* at 156.

<sup>141</sup> Above n 126.

<sup>142</sup> Above n 134 at 159.

<sup>143</sup> *Ibid* at 158, and authorities cited there.

<sup>144</sup> *Ibid* at 159.

<sup>145</sup> *Ibid* at 158.

<sup>146</sup> *Ibid*.

<sup>147</sup> Above n 126.

of delivery and acceptance. The case is a classic application of the principles governing the payment of money. Also, the existence of adjusting post-payment rejection and restitution rights is highlighted in the judgments.<sup>148</sup> A less convincing part of the decision is the view that payment was achieved as soon as the money had been laid by the paying banker on the counter. Arguably, at that point ‘appropriation’ had been achieved, although not necessarily ‘assent’.<sup>149</sup> Nevertheless, in that case it was the payee who came to the payer specifically to obtain payment. Under those circumstances, an advance assent to the appropriation of any money tendered might be inferred.

*Balmoral* (1974)<sup>150</sup> must be understood in light of the specific nature of a depositor’s payment into his own bank account. Unlike payment in pursuance of a payment obligation, such a payment does not involve an unconditional appropriation or tender of a specific amount. At any point before certain recordings are made, notwithstanding even delivery of the money to the banker, the depositor may change his mind and walk away with all the money or part of it. Counting and examination by the payee-banker takes place in the prepayment stage where the final amount, as well as the identity of the individual coins and notes to be deposited must be agreed upon. In that respect, the payment of money in a bag into a bank account is very much like the sale of ‘[all] the bark stacked at Redbrook at 9.5s. per ton’ in *Simmons v Swift* (1826).<sup>151</sup> It was held in that case that the property did not pass until the bark had actually been appropriated by ascertaining its weight and price. It seems to follow that in *Balmoral* (1974), had the money in the teller’s hand also been robbed, such money would still have been of the paying depositor and not of the payee-bank.

#### 4. THE ORDER TO PAY MONEY: THE CONCEPT OF A PAYMENT MECHANISM

##### 4.1 Transmission of Monetary Value: General Framework

###### (i) *The Basic Model*

As pointed out in the previous sections of this chapter, in its simplest sense, the payment of a debt contemplates payment of money in specie, or cash, namely,

<sup>148</sup> Nevertheless, two judges were unclear as to the distinction between the issue of ‘payment’ and the payer’s right to recover in restitution an *entire* mistaken payment. *Ibid* Ex. 133–34, E.R. 53, per Erle CJ and Ex. 135, E.R. 54, per Williams J. The clearer and better view was expressed by Byles J: ‘even if this had been a payment made under . . . a mistake of facts as would have entitled the bankers to recover back the money from the [payee], by an action for money had and received, I must entirely withhold my assent from the proposition that they could justify the act of seizing the person to whom they had voluntarily paid the money, and picking his pocket.’ *Ibid* Ex. 136–37, E.R. 54.

<sup>149</sup> For the use of this terminology, borrowed from the law of sale of goods, see opening paragraph to section 3.3 above.

<sup>150</sup> Above n 134.

<sup>151</sup> (1826) 5 B. & C. 857 at 858, 108 E.R. 319 at 319 (K.B.).

the physical delivery of monetary objects – presently being banknotes and coins – from debtor to creditor. This method of payment requires the availability of the monetary objects in the debtor's hands, and their physical delivery or transportation to the creditor. Together with paper money, payment mechanisms have developed as a response to the scarcity of coins as exclusive monetary objects;<sup>152</sup> however, payment mechanisms evolved also as means to reduce, or even to eliminate altogether, costs and risks involved in the transportation of monetary objects, being coins or banknotes, in payment of debts. Furthermore, as demonstrated in section 3 above, payment in cash is cumbersome; its proof may invoke evidentiary issues; moreover, payment in cash may give rise to situations in which the application of the law is not always clear and predictable. Obviously, the emergence of non-cash payment mechanisms for the transmission of monetary value in payment of debts is bound to bypass all such difficulties. Finally, from the perspective of the modern state, payment mechanisms are fiscally advantageous, as they provide records for transactions.

When investigating the origins of payment mechanisms, a kind of chicken-and-egg problem arises: historians are unsure whether (i) scarcity of monetary objects produced payment mechanisms that resulted in the reduction of the transportation of monetary objects, or (ii) payment mechanisms were consciously set up to reduce the transportation of monetary objects so as to bring about a reduction in the amount of actual money in circulation. Historically, the emergence of payment mechanisms addressed both concerns. In any event, even if their emergence was necessitated by the scarcity of monetary objects, the development and growth of payment mechanisms enhanced the objective of reduction or avoidance of the carriage or transportation of monetary objects. In the final analysis, this objective has served as the primary *raison d'être* of payment mechanisms.

Physical transportation of money in specie has two serious drawbacks. First, large quantities of monetary objects are bulky and require space. This raises difficulties and increases costs in connection with storage as well as with transportation in commerce. Second, transportation of monetary objects gives rise to risks of accidental loss and theft. The cumbersome nature and potential uncertainties associated with payment in cash as set out in the previous section have been linked to these two drawbacks, inherent in the possession of money in specie. All this has been met in connection with payment of debts by the emergence and development of payment mechanisms.

A payment mechanism can be broadly described as any method involving a third party other than the debtor and creditor,<sup>153</sup> facilitating the transmission of

<sup>152</sup> For the scarcity of (coined) money in medieval England, see JL Bolton, *The Medieval English Economy 1150–1500* (London: Dent & Sons, 1980) at 73. See also SJ Bailey, 'Assignments of Debts in England from the Twelfth to the Twentieth Century' Part I (1931), 47 *LQR* 516 at 518; Part II (1932), 48 *LQR* 248 at 254.

<sup>153</sup> Payment by bilateral setoff between debtor and creditor, which is a method of payment (see eg Fox, above n 3 at 30) is thus excluded.



monetary value in the payment of a debt,<sup>154</sup> which enables the debtor to avoid the transportation of money in specie and its physical delivery to the creditor in the discharge of the debt. Physical transportation and delivery of money in specie is avoided by shifting the risks and administration involved therein to a third party. This third party may or may not be one who is in the business of taking such risks. Payment may or may not be in specie. In any event, as explained below, such payment may discharge more than one debt, thereby reducing instances of physical transportation of money in specie and the risks and costs involved in this endeavour.

A payment mechanism does not involve the physical delivery of a bag of money from the debtor to the creditor via a third party carrier. Coins and banknotes, of which money consists, are fungible chattels. As such they are mutually interchangeable, namely replaceable by equal quantities and equal qualities.<sup>155</sup> For that reason, transmission of monetary value via a payment mechanism is not identical to the physical transfer (or transportation) of money in specie. Coins and banknotes that may be delivered by the third party to the creditor need not be set aside or earmarked by the debtor.<sup>156</sup>

The operation of a payment mechanism is premised on the discharge of a debt by virtue of an authorized payment made by a third party, frequently a debtor's debtor. Besides discharging the original debt, this payment discharges the debt of the debtor's debtor. Alternatively, where there is no such pre-existing debt owed by the third party to the debtor, this payment, besides discharging the original debt, creates a new debt owed by the original debtor to the third party. The specific mechanics, and the mode by which the physical transportation of money is avoided or eliminated by those specific mechanics, will be discussed in this section.

### *(ii) The Three-party Payment Mechanism*

A payment mechanism is fundamentally a three-party arrangement.<sup>157</sup> Thereunder, where **Debtor** owes money to **Creditor**, **Debtor's** discharge is to be effected by a third-party **Paymaster's** payment to **Creditor**, made with **Debtor's** authority. This payment either creates a new debt owed by **Debtor** to **Paymaster**, or discharges **Paymaster's** existing debt to **Debtor**. In the latter case, one actual payment, made by **Paymaster** to **Creditor**, discharges two debts: one owed by **Debtor** to **Creditor** and the other owed by **Paymaster** to **Debtor**. This is one instance whereby the carrying of money in specie is avoided. Further reduction in the transportation of money is achieved where **Paymaster** is a depository of

<sup>154</sup> For the purpose of the definition, payment by way of gift is not to be treated separately from payment of a debt. Also, 'debt' is not necessarily a pre-existing debt. It can be created and discharged simultaneously.

<sup>155</sup> See Lawson and Rudden, above n 2 at 27, for the definition of fungible goods.

<sup>156</sup> In fact, no physical deliveries may occur at all. See in general section 4.1(iii) below.

<sup>157</sup> Multipartite payment mechanisms are extensions of three-party mechanisms. See section 4.1(iii) below.

money owing **Debtor** on account of money **Debtor** entrusted with **Paymaster**. In such a case, payment by **Paymaster** to **Creditor** need not necessarily be made in specie. Rather, it can be accomplished by a mere bookkeeping entry, namely by the creation of a new debt running from **Paymaster** in favour of **Creditor**, in lieu of the old debt owed by **Paymaster** to **Debtor** for that sum of money.<sup>158</sup> In such a case, it is the face value of money, rather than money itself, that has been transmitted via the payment mechanism.

The three-party model contains the basic elements of all payment mechanisms. This can be demonstrated by fitting into the model all types and classes of payment mechanisms presently used.<sup>159</sup> In connection with the discussion that immediately follows, it is useful to keep in mind that terminology which has developed in connection with modern payment mechanisms contemplates that both **Debtor** and **Creditor** have bank accounts, that payment is accomplished by debiting **Debtor**'s account and crediting **Creditor**'s,<sup>160</sup> that **Paymaster** is a depository institution where **Debtor** has his bank account, and that **Creditor** has a bank account either with **Paymaster** or another depository institution.<sup>161</sup> Nevertheless, this general description of modern payment mechanisms, while helpful in understanding the terms, is not required for establishing the terminology.<sup>162</sup>

Payment mechanisms are either credit or debit transfers. Where **Debtor**'s instructions are communicated directly to **Paymaster**, there is a credit transfer. Where **Debtor**'s instructions are communicated to **Paymaster** indirectly, namely via **Creditor**, there is a debit transfer. In the former, **Debtor**'s instructions communicated to **Paymaster** 'push' funds to **Creditor**. In the latter, **Creditor**'s communication to **Paymaster** 'pulls' or 'draws' funds from **Debtor**.<sup>163</sup> To that end, in a debit transfer, it is not **Debtor**'s instructions which are dealt with by the banking system; rather, it is **Creditor**'s instructions, initiated on the basis of **Debtor**'s authorization, which are processed. Indeed, as a matter of banking operation, a credit transfer commences with a debit to **Debtor**'s account and is completed

<sup>158</sup> Indeed, the payer's risk of transportation before payment, and the payee's risk of carrying money after payment, are two sides of the same coin, namely of the risk of possessing money.

<sup>159</sup> Modern payment methods are listed eg in the Annex to the EU Payment Services Directive, being Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market.

<sup>160</sup> For a discussion on 'account transfer', though in a specific context of a credit transfer, highlighting the distinction between payment instructions and the resulting account transfer, see eg *Libyan Arab Foreign Bank v Bankers Trust Co* [1988] 1 Lloyd's Rep. 259 at 273, per Staughton J (Q.B. (Com. Ct.)).

<sup>161</sup> I purposefully avoid the giving of precise definitions to technical terms like 'bank account', 'account', or 'depository institution'. The terms are used here loosely in their colloquial meaning.

<sup>162</sup> The involvement of **Creditor**'s bank, namely the depository institution where **Creditor** keeps his bank account, is discussed in section 4.1(iii) below.

<sup>163</sup> Accordingly, note the reverse role of **Debtor** and **Creditor** in each payment application. Thus, **Debtor** is the originator in a credit transfer and the destination party in a debit transfer, while **Creditor** is the originator in a debit transfer and the destination party in a credit transfer. See eg B Geva, 'International Funds Transfers: Mechanisms and Laws' in C Reed, I Walden and L Edgar (eds), *Cross-Border Electronic Banking: Challenges and Opportunities*, 2nd edn (London; Hong Kong: Lloyd's of London Press, 2000) ch 1, 1 at 1–2.

with a credit posted to **Creditor's** account. Conversely, a debit transfer may commence with a credit posted (albeit provisionally) to **Creditor's** account and is completed with a debit to **Debtor's** account.<sup>164</sup>

Payment instructions are processed either individually or in bulk. As well, payment mechanisms, whether credit or debit transfers, are either paper-based or electronic funds transfers. Where payment instructions are embodied in a piece of paper, there is a paper-based system. Otherwise, particularly where the instructions are recorded on a magnetic tape or in any other electronic message medium, there is an electronic funds transfer system. Thus, for example, while the cheque is a paper-based bulk debit system, the wire transfer system is typically for electronic credit transfers processed individually.

Paper embodying **Debtor's** instructions may circulate so as to put its holder from time to time in **Creditor's** shoes. It can be characterized then as paper currency. The most notable example of paper currency is the bill of exchange, including the cheque. Not every type of paper embodying **Debtor's** instructions circulates as paper currency. In principle, only paper used in a debit transfer system is capable of being paper currency.<sup>165</sup> However, a paper-based debit system does not necessarily require paper currency.

A payment system, whether credit or debit transfer, whether paper-based or electronic funds transfer, where (i) **Creditor** is not to be paid in cash (or otherwise in specie), and (ii) **Debtor's** payment instructions are not embodied in paper currency, is called a GIRO system.<sup>166</sup> The term 'GIRO' is taken from the Greek word for circle. 'Giro denotes the cyclic operation involved in the transfer of credit balances from one bank account to another.'<sup>167</sup> Typically, bulk credit and non-cheque debit transfers<sup>168</sup> are GIRO systems.

Given the elasticity of the basic model and its resulting comprehensiveness, an examination of the basic features of the model will be made.

The function of a payment mechanism is to reduce instances of carrying money in specie, and thereby to avoid the cost and risk associated with the physical transportation of money. **Paymaster** is therefore likely to be either a debtor of **Debtor**, or else one who expects to become **Debtor's** debtor. Alternatively, payment by **Paymaster** to **Creditor** may be a form of credit extension from

<sup>164</sup> Regardless of whether a given payment process is a debit or credit transfer, in a retail payment, **Creditor** may benefit from either a payment obligation of **Paymaster** or from a guarantee of payment by **Paymaster**, **Creditor's Banker**, or even a third party. Under modern practices, this is the case, eg, for bank drafts and payment cards.

<sup>165</sup> This is so because a payment order embodied in paper currency must be communicated to **Paymaster** by the holder, namely either **Creditor** or any subsequent transferee.

<sup>166</sup> For a comprehensive discussion on GIRO systems, see RR Pennington, AH Hudson and JE Mann, *Commercial Banking Law* (Estover, Plymouth: McDonald and Evans, 1978) at 275–305; EP Ellinger, E Lomnicka and R Hooley, *Ellinger's Modern Banking Law*, 4th edn (Oxford: Oxford University Press, 2006) ch 13.

<sup>167</sup> Ellinger, *ibid* at 512.

<sup>168</sup> In principle, the process of cheque collection is no different from that of any other debit transfer; cheques are nevertheless excluded from GIRO systems, since, at least in theory, payment in cash to the payee-**Creditor**, upon presentment to the drawee-**Paymaster**, is not excluded.

**Paymaster** to **Debtor**, designed to pay off **Debtor's** indebtedness to **Creditor**. In the latter case, **Paymaster** is a money lender. The proceeds of **Paymaster's** loan to **Debtor**, rather than being paid from **Paymaster** to **Debtor**, and then from **Debtor** to **Creditor**, are paid directly by **Paymaster** to **Creditor**, thereby reducing the instances where money is to be carried in specie.<sup>169</sup>

Now suppose **Paymaster** is neither extending credit to **Debtor**, nor a debtor or a would-be debtor to **Debtor**. Under those circumstances, inasmuch as **Paymaster's** payment to **Creditor** results in the creation of a new debt owed by **Debtor** to **Paymaster**, which has to be paid immediately in specie, no reduction in the transportation of money has resulted from the employment of **Paymaster** to pay **Debtor's** debt to **Creditor**. A payment mechanism is unlikely to be used in those circumstances. The only exception is the unusual case where **Paymaster**, who is in the business of transmitting monetary value, contractually assumes **Debtor's** risks involved in the physical transportation of money and undertakes to pay **Creditor**, while neither extending credit to **Debtor**, nor obtaining the money from **Debtor** in advance.

The typical commercial settings, which give rise to the use of payment mechanisms, wherein **Paymaster** is either a debtor or a would-be debtor of **Debtor**, will now be examined.

Where **Paymaster** is a debtor of **Debtor**, **Paymaster's** debt to **Debtor** may have arisen from an ordinary transaction between them. Alternatively, **Paymaster** may be **Debtor's** debtor by virtue of **Debtor's** delivery of money to **Paymaster**.<sup>170</sup> Such a delivery may be for the exact sum of money to be paid to **Creditor** and particularly for transmitting that amount to **Creditor**, in which case **Paymaster** is a money-transmitter. In such a case the reduction of the transportation of money is not immediately apparent, as rather than **Debtor** paying directly to **Creditor**, we have **Debtor** paying to **Paymaster** who pays **Creditor**. Nonetheless, where **Debtor** and **Creditor** are geographically far apart, by delivering the money to **Paymaster** in **Debtor's** location, **Debtor** has shifted to **Paymaster** the risk of the physical transportation of money. As a money-transmitter, **Paymaster** is in the business of taking this risk. Furthermore – as will be explained later in section 4.1(ii) – as a money-transmitter, **Paymaster** is likely to facilitate the transmission of monetary value to **Creditor** without the physical transportation of money from **Debtor's** location. In any event, having received the money from **Debtor**, **Paymaster** becomes indebted to **Debtor**. Having paid **Creditor**, **Paymaster** discharges **Debtor's** debt to **Creditor** as well as **Paymaster's** own debt to **Debtor**.

<sup>169</sup> By paying directly to **Creditor**, **Paymaster** also ensures that the proceeds of his loan are in fact used for payment to **Creditor**. This is important to **Paymaster** where **Debtor's** indebtedness to him is to be secured by goods to be purchased from **Creditor** with the proceeds of the loan.

<sup>170</sup> The delivery of money, as opposed to the delivery of a specific chattel, gives rise to a debt: *Core's Case* (1537) 1 Dyer 20a at 22a, 73 E.R. 42 at 46 (K.B.). See also *Bretton v Barnet* (1599) Owen 87, 74 E.R. 918 (K.B.). This will be discussed further in ch 9, section 2 below.

Another instance of **Paymaster** becoming a debtor of **Debtor** by virtue of **Debtor's** delivery of money to **Paymaster** is where **Paymaster** is a depository of money, that is, a banker.<sup>171</sup> In such a case, **Debtor's** deposit is likely to be in a larger amount than his debt to **Creditor** and is to take place prior to, and irrespective of, **Debtor's** instructions to **Paymaster** to pay **Creditor**. **Paymaster's** debt to **Debtor**, then, is in the amount of **Debtor's** entire deposit. In paying **Creditor** upon **Debtor's** instructions, besides discharging **Debtor's** debt to **Creditor**, **Paymaster** discharges part of **Paymaster's** own debt to **Debtor**, in the amount of payment to **Creditor**. Payment by **Paymaster** to **Creditor** thus reduces the physical transportation of money in specie. **Paymaster**, rather than paying **Debtor** who is to pay **Creditor**, pays directly to **Creditor**. Moreover, if **Creditor** so wishes, no actual payment needs to take place as **Paymaster**, a depository institution, may accomplish payment by becoming **Creditor's** debtor in the sum of the payment.

Where **Paymaster** is a banker, the reduction in the risk of transportation is a by-product of the elimination of the risk of possessing money in general, inherent in the idea of entrusting money to a banker. Where **Paymaster** is a money-transmitter, the delivery of money to **Paymaster** by **Debtor** may also be designed to protect **Debtor** from risks involved in the use of foreign currency in international trade.<sup>172</sup> Thus, where the coin of payment to **Creditor** in a foreign jurisdiction is not the one current in **Debtor's** place, **Paymaster**, a money-transmitter, is the one who undertakes, in return for the delivery to him by **Debtor** of money in **Debtor's** home currency, to pay **Creditor** in **Creditor's** own currency. This way, **Debtor** avoids the need to acquire the foreign currency in specie, and the incumbent risk of obtaining counterfeit coins of a currency **Debtor** is not familiar with. In sum, the delivery of money to a banker or money-transmitter serves various purposes. Their attainment through the emergence of one **Paymaster** who is indebted to **Debtor** has been instrumental in the development of payment mechanisms.

Where **Paymaster** is not indebted to **Debtor** at the time of carrying out **Debtor's** instructions to pay **Creditor**, **Paymaster's** payment, besides discharging **Debtor's** debt to **Creditor**, creates a new debt from **Debtor** to **Paymaster**. This also remains true where **Paymaster** expects to become **Debtor's** debtor in the future. Nonetheless, in terms of the universality of the theory underlying the

<sup>171</sup> In general, a banker is one who borrows in order to lend. People deposit their money with a banker for safekeeping, but from a legal perspective, they lend him the money. For the debt relationship created by the deposit of money with a banker, see *Foley v Hill* (1848) 2 H.L.C. 28, 9 E.R. 1002. In the course of his judgment, Lord Cottenham said (H.L.C. 36, E.R. 1005–06) that '[t]he money placed in the custody of a banker is . . . the money of the banker . . . but he is of course answerable for the amount'. Lord Brougham said (H.L.C. 44, E.R. 1008) that the 'trade of a banker is to receive money, and use it as if it were his own, he becoming debtor to the person who has lent or deposited with him the money to use as his own'. According to Lord Campbell (H.L.C. 45, E.R. 1009), 'the relation between banker and customer . . . [is] that of debtor and creditor'.

<sup>172</sup> See in general, W Holdsworth, *A History of English Law*, 2nd edn (London: Methuen & Co, Sweet and Maxwell, 1937, reprinted 1966) vol VIII at 177.

operation of the payment mechanism, where **Paymaster** expects to be **Debtor's** debtor, **Paymaster's** payment to **Creditor** should not be regarded as creating a new debt owed by **Debtor** to **Paymaster**. Rather, it is better to look upon it as a prepayment of the future debt **Paymaster** is to owe **Debtor**. Not made in specie, such prepayment avoids the need to carry money in actual payment in the future.

In fact, where **Paymaster** expects to be **Debtor's** debtor, and sometimes where **Paymaster** is already indebted to **Debtor** other than by taking delivery of money as a money-transmitter or banker, the utility of a payment mechanism, or the reduction of the transportation of money, is premised on the existence of a long term mutual business relationship between **Debtor** and **Paymaster** with debits and credits going back and forth. Typically **Debtor** and **Paymaster** are fellow merchants having mutual dealings producing a series of mercantile transactions between them, with purchases and sales as well as other debits and credits going in both directions. Payments by **Paymaster** on behalf of **Debtor** to **Creditor** are part of these mutual dealings. They may be treated as payments for **Paymaster's** indebtedness to **Debtor**, past and future. In practice, both **Debtor** and **Paymaster** contemplate a periodic net settlement between them, with one payment of the resulting balance reflecting the adjustment of their mutual debts. Such a single payment may be made in specie, or by using another payment mechanism, that is, by employing an additional participant, viz a debtor (or would-be debtor) of the one who is the ultimate debtor in the resulting net balance between **Debtor** and **Paymaster**.<sup>173</sup> Even when the final periodic net settlement between **Debtor** and **Paymaster** is by payment in specie, inasmuch as such a single payment substitutes numerous payments in specie going back and forth between them, it represents a substantial saving in the amount of transportation of money. In effect, as was already indicated, the saving arises from the ability of **Paymaster's** payments to **Creditor** to reduce **Paymaster's** indebtedness to **Debtor**, both past and future.

In summary, a reduction in the physical transportation of money takes place wherever the authorized payment by **Paymaster** to **Creditor** discharges **Debtor's** debt to **Creditor** without creating a debt owed by **Debtor** to **Paymaster** immediately payable separately in specie. The expansion of commerce has facilitated the emergence of an institutional **Paymaster** serving as a money lender, depository for money (or banker), money-transmitter, or fellow merchant having mutual dealings with another merchant. The effect of a payment by this **Paymaster** to **Creditor**, a creditor of **Debtor**, on **Paymaster's** balance with **Debtor**, where **Debtor** is **Paymaster's** borrower, depositor, entruster, or fellow merchant, has been the cornerstone of the operation of payment mechanisms.

<sup>173</sup> That participant may pay in specie, by using another payment mechanism, or by crediting the payee's account with him.

*(iii) Multipartite-payment Mechanisms*

Where **Paymaster** is either a money-transmitter or a banker, a three-party payment mechanism can expand to form a four-party arrangement, thereby bringing about a further reduction of the physical transportation of money.

First to be dealt with is a four-party payment mechanism in which a money-transmitter acts as **Paymaster**, who is to transmit monetary value for **Debtor** to **Creditor** situated in another territory. Thus, where **Debtor** and **Creditor** are geographically apart from each other, in order to avoid the risk of physical transportation of money, **Paymaster**, who is normally situated in **Debtor's** area, must employ a **Correspondent**, located in **Creditor's** territory. Actual payment to **Creditor** is accordingly to be made by **Correspondent**.

Obviously, payment by **Correspondent** to **Creditor**, while discharging **Paymaster's** debt to **Debtor**, as well as **Debtor's** debt to **Creditor**, creates a new debt owed by **Paymaster** to **Correspondent**. Usually, however, such a debt is not to be paid separately in specie. Typically, **Correspondent** is a money-transmitter. **Paymaster** and **Correspondent** are likely to have a long term mutual business relationship. There may be additional occasions where **Correspondent** is to pay pursuant to **Paymaster's** instructions. At the same time, there are likely to be other occasions where the reverse occurs, namely where **Paymaster** is to pay pursuant to **Correspondent's** instructions. Such payments by **Paymaster** are to discharge debts of those residing in **Correspondent's** own area, owed to those located in **Paymaster's** territory. These payments made by **Paymaster** are also to discharge **Correspondent's** debts to those entrusting him with money and instructing him to accomplish payments to their creditors situated at **Paymaster's** place. In turn, payments by **Paymaster** are to create debts owed by **Correspondent** to **Paymaster**. These debts are not to be paid separately in specie. There will be a periodic net settlement between **Paymaster** and **Correspondent**, with one payment of the resulting balance reflecting the adjustment of their mutual debts. Such a single repayment may be made in specie, or by using another payment mechanism, that is, by employing an additional participant, viz, a debtor of the one who is the ultimate debtor in the resulting net debt between **Paymaster** and **Correspondent**.

In the final analysis, it is in this fashion that the use of a money-transmission network reduces the physical transportation of money. Admittedly, in a four-party payment mechanism we have **Debtor** paying **Paymaster**, **Correspondent** paying **Creditor**, and an ultimate settlement between **Paymaster** and **Correspondent**. This sounds more involved than one physical delivery of money from **Debtor** to **Creditor**. Yet, the use of a four-party payment mechanism avoids the physical transportation of money between two distant locations. All physical deliveries in a money-transmission network take place in separate locations (**Debtor/Paymaster**, **Correspondent/Creditor**). Costs and possibly risk associated with a single physical transportation from place to place are higher than those involved in several local physical deliveries. Needless to say, all ad hoc local deliveries are avoided where **Paymaster** and **Correspondent**, in



addition to being money-transmitters, are also bankers. As a depositary of Debtor's money, Paymaster will instruct Correspondent to pay Creditor by merely reducing his (Paymaster's) indebtedness to Debtor. For his part, Correspondent will pay Creditor by merely becoming Creditor's debtor in the sum of the payment.

In fact, a four-party payment mechanism involving Paymaster and Correspondent as two money-transmitters (hereafter 'four-party money-transmitter payment mechanism') consists of two separate three-party mechanisms. One is initiated by Debtor's order to Paymaster to pay Creditor. The other is initiated by Paymaster's order to Correspondent to pay Creditor. Obviously, these two mechanisms are closely related. The latter is initiated in performance of the order contained in the former. Payment by Correspondent to Creditor discharges Debtor's debt to Creditor as well as Paymaster's debt to Debtor.<sup>174</sup>

Where Paymaster, usually a banker, but possibly also a money-transmitter, is instructed to pay to a bank account, a four-party payment mechanism is of an entirely different nature. Such a mechanism involves a banker who is either to collect for Creditor, or to pay him. Thus, where Debtor instructs Paymaster to pay Creditor, Creditor may appoint a banker to collect the money. Debtor's instruction to Paymaster is communicated then to Paymaster, *indirectly*, through Creditor's Banker, acting under the authority of Creditor. Alternatively, Debtor may *directly* instruct Paymaster to pay into the account of Creditor with a banker. The former case involves a debit transfer, while the latter gives rise to a credit transfer. Cheque collections and GIRO payment systems fall into this category.<sup>175</sup>

In each of these cases, Creditor's Banker is not to pay Creditor in specie. As a depositary of money, he becomes Creditor's debtor in the sum of the payment. In addition, between Creditor's Banker and Paymaster, as participants in a domestic or international banking network, payment by Paymaster is not to be made in cash but, rather, is to be made either on correspondent accounts or as part of a periodic settlement.

By eliminating altogether an actual payment in cash to Creditor, a four-party payment mechanism involving Paymaster and Creditor's Banker (hereafter 'four-party banker payment mechanism'), produces a further reduction in the physical transportation of money. In this respect, the analysis of a four-party banker payment mechanism also covers the case of a three-party banker mechanism, in which Paymaster is a banker, and Creditor does not take the money from Paymaster, but leaves it in Paymaster's hands. Such a case is a specific application of the four-party banker payment mechanism, except that it involves one bank acting as both Paymaster and Creditor's Banker. In any event, unlike a four-party money-transmitter mechanism, a four-party banker mechanism does not consist of two related mechanisms. Rather, it is truly an expanded three-party system with Creditor's Banker forming Creditor's extension or long arm.

<sup>174</sup> This will be discussed in section 4.2(iii) below.

<sup>175</sup> For all such payment systems see section 4.1(ii) above.



A four-party payment mechanism can expand to include further parties. For example, in a four-party money-transmitter mechanism, **Creditor**, who is to obtain payment from **Correspondent**, may instruct **Correspondent** to make payment to **Creditor's** own creditor; **Correspondent** may either pay directly, or instruct his own correspondent to make such a payment. Otherwise, in a four-party banker mechanism, **Paymaster** may transmit payment (though as a rule not physically) to **Creditor's Banker** via intermediary bankers. In fact, whenever **Creditor's Banker** is not a correspondent for **Paymaster**, an intermediary banker, acting as a correspondent, is to be appointed by **Paymaster** in a credit transfer, and by **Creditor's Banker** in a debit transfer. Where this intermediary banker is not **Correspondent** of **Creditor's Banker** in a credit transfer, and of **Paymaster** in a debit transfer, more intermediary bankers may be involved in the chain.

## 4.2 Transmission of Monetary Value: Legal Issues

### *(i) Introductory Notes*

In this section, legal issues arising in the course of the transmission of monetary value via payment mechanisms will be dealt with. Beginning with a three-party mechanism, an outline of the primary issues involved and an attempt to suggest a framework for their resolution will be presented. This will be done by exploring the legal effect of the payment order. Second, the issues arising in the course of the operation of a four-party money-transmitter payment mechanism will be outlined. Since the latter is a combination of two three-party payment mechanisms, pertinent legal analysis will be abbreviated. Third, the issues arising in the course of the operation of a four-party banker payment mechanism will be set out. Since a four-party banker payment mechanism is really an expanded three-party system with **Creditor's Banker** forming **Creditor's** extension or long arm, discussion will highlight only what is modified in such a case compared to any other three-party payment mechanism. Thus, it is the three-party payment mechanism that is to be most extensively discussed.

### *(ii) Three-party Payment Mechanism*

*The Issues* The operation of a three-party payment mechanism gives rise to four legal issues. They are enumerated below as follows:

1. **Paymaster's** duty towards **Debtor**;
2. **Creditor's** right against **Paymaster**;
3. **Debtor's** liability and discharge towards **Creditor**; and
4. **Paymaster's** discharge towards, or debt owed by, **Debtor**.

The first two issues are concerned with **Paymaster's** duty to comply with **Debtor's** instructions. The first of them relates to **Paymaster's** duty towards

**Debtor** and the second to **Paymaster's** duty towards **Creditor**. The last two issues primarily deal with the timing aspects of the discharges achieved by the use of payment mechanisms.

*The first issue* is **Paymaster's** duty towards **Debtor**. It is principally concerned with the basis of this duty. It also involves questions as to the manner in which **Paymaster's** duty towards **Debtor** is put in force, and the result of its breach by **Paymaster**.

In dealing with *the second issue* relating to **Creditor's** right against **Paymaster**, it is to be assumed that **Debtor** and **Creditor** have agreed that **Creditor** is to be paid by **Paymaster**. Stated otherwise, it is undisputed that as against **Debtor**, **Creditor** is entitled to recover from **Paymaster** in satisfaction of **Debtor's** debt to him. Under these circumstances, three questions arise in connection with **Creditor's** right against **Paymaster**:

- (a) Is **Creditor** entitled, as against **Paymaster**, to recover from him?
- (b) If yes, what is the basis of **Creditor's** entitlement from **Paymaster**, and when is it effective? Specifically, does **Creditor's** entitlement originate from the communication of **Debtor's** instructions to **Paymaster** to pay **Creditor**, or rather, is it based on some act or promise made by **Paymaster** and if so, what makes this act or promise binding towards **Creditor**? Finally,
- (c) If **Creditor** is entitled to recover from **Paymaster**, what is the scope of **Creditor's** entitlement?

This third question has three separate facets:

*First*, may **Paymaster** raise against **Creditor** defences available to him against **Debtor**?

*Second*, is **Creditor's** entitlement from **Paymaster** dependent on lack of defences on **Debtor's** part as against **Creditor**?

*Third*, does **Creditor** overcome a third party's adverse claims to his (**Creditor's**) right against **Paymaster**?

For its part, out of the four issues set out above, *the third issue* is concerned with the time of **Debtor's** discharge towards **Creditor**. Having instructed **Paymaster** to pay **Creditor**, when is **Debtor** discharged? Several alternatives may be considered.

Thus, is **Debtor** discharged:

- (a) Merely upon instructing **Paymaster** to pay **Creditor**?
- (b) Upon actually being owed money by **Paymaster** and instructing him to pay **Creditor**?
- (c) Upon **Paymaster's** assent to carry out **Debtor's** instructions?
- (d) Upon the notification to **Creditor** of any of the foregoing? or
- (e) Upon actual payment to **Creditor**?<sup>176</sup>

<sup>176</sup> 'Actual payment' is not necessarily payment in specie. Eg, it may also occur by crediting **Creditor's** account with **Paymaster**.

As well in relation to the third issue:

- Prior to his own discharge, has **Debtor** incurred liability to **Creditor** for **Paymaster's** performance?
- If yes, when does this liability originate, and what is its relationship with:
  - (i) **Debtor's** original debt to **Creditor**? and with
  - (ii) **Paymaster's** liability to **Creditor**?

Finally, *the fourth issue* deals with **Paymaster's** position against **Debtor** after the former has received the latter's instructions. When does **Paymaster** get his discharge from **Debtor**, or become **Debtor's** creditor (so as to be discharged from his future debt to **Debtor**), as the case may be? Does it happen as a result of **Debtor's** discharge towards **Creditor**? Alternatively, does it happen upon the occurrence of any of the events enumerated above in connection with the third issue, irrespective of whether this is the event that also discharges **Debtor's** indebtedness to **Creditor**?

The starting point for discussing *all four issues* is the determination of the legal nature of the three-party payment mechanism. As will be seen below, the analysis may give us some definite answers to some questions, along with some clues as to others. The answer to the few remaining questions is to be left to inter-party agreements, irrespective of the characterization of their legal relations. The discussion below will present alternative characterizations and the sets of results flowing from them.

*First and Second Issues: Paymaster's Duties towards Debtor and Creditor* The payment order given by **Debtor** to **Paymaster** may be characterized either as a mere mandate, that is, in the common law sense, a mere authority to pay **Creditor** on **Debtor's** behalf, or else as an assignment to **Creditor** of **Paymaster's** (existing or future) debt owed to **Debtor**. First to be dealt with are the issues relating to **Paymaster's** duty towards **Debtor**, as well as to **Creditor's** right against **Paymaster**, under each alternative.

As a mere mandate, **Debtor's** payment order binds **Paymaster** neither against **Debtor** nor against **Creditor**. Indeed, the mere authority given to **Paymaster** by **Debtor** to pay **Creditor** does not require **Paymaster** to abide by **Debtor's** payment order, except that **Paymaster** may have bound himself under a separate agreement with **Debtor**. Such a pre-existing agreement may easily be implied where **Paymaster** received money from **Debtor** for the specific purpose of transmitting it to **Creditor**, as where **Paymaster** is a money-transmitter. Needless to say, an undertaking by **Paymaster** to carry out **Debtor's** payment order may also be given to **Debtor** in advance, under an express agreement between them.<sup>177</sup> An obligation to honour **Debtor's** payment orders may also be fastened upon

<sup>177</sup> Such an express agreement may be made under a bank account agreement where **Paymaster** is the custodian of **Debtor's** money, namely **Debtor's** banker. Alternatively, it can be made under a loan agreement where **Paymaster** is a lender to **Debtor**, who is to give the proceeds of the loan directly to **Creditor**.

**Paymaster** and superadded to **Paymaster's** contractual relation with **Debtor** 'according to the custom of the trade'.<sup>178</sup> Nevertheless, an explicit or implicit agreement between **Debtor** and **Paymaster** requiring **Paymaster** to follow **Debtor's** instructions is by itself a matter between **Debtor** and **Paymaster** only. In the absence of some kind of third party beneficiary theory, such an agreement does not entitle **Creditor** to recover from **Paymaster**.

Alternatively, **Debtor's** payment order may create an assignment. The effectiveness of an assignment depends on the manifestation of the assignor's intention, and not upon its communication to the assignee.<sup>179</sup> An equitable assignment 'may be addressed to the debtor' and 'couched in the language of command'.<sup>180</sup> Accordingly, the communication of **Debtor's** order to **Paymaster** may be viewed as an assignment to **Creditor** of **Paymaster's** debt owed to **Debtor**.

An assignment of a debt entitles the assignee as well as binds the obligor who has been notified of it.<sup>181</sup> Inasmuch as it constitutes an assignment, **Debtor's** payment order thus entitles **Creditor** as well as binds **Paymaster**. **Paymaster** can discharge his debt to **Debtor** only by payment to **Creditor**. **Paymaster** is put under a duty to pay **Creditor** and such a duty may be enforced directly against **Paymaster** not only by **Debtor**, but also by **Creditor**.

Whether **Paymaster** is required to pay immediately to the assignee **Creditor** may depend on whether the assigned debt (owed from **Paymaster** to **Debtor**) is presently owed and payable. In such a case, **Paymaster** is required to follow **Debtor's** instructions as communicated to him. At the same time an assignment of a future debt, while binding the obligor and entitling the assignee,<sup>182</sup> does not, by itself, require the obligor to pay the assignee prior to the maturity of the assigned debt. **Paymaster** is to pay **Creditor** only upon the maturity of **Paymaster's** debt to **Debtor**. Nonetheless, in such a case of a future debt owed by **Paymaster** to **Debtor**, under a pre-existing agreement with **Debtor**, implicit or explicit, **Paymaster** may undertake to follow **Debtor's** instructions and pay **Creditor** prior to the maturity of the assigned debt.<sup>183</sup> But such an agreement is

<sup>178</sup> *Foley v Hill*, above n 171, at H.L.C. 31, E.R. 1004; argument in relation to the banker's duty to honour the depositor's cheques.

<sup>179</sup> M Furmston, *Cheshire, Fifoot & Furmston's Law of Contracts*, 15th edn (New York: Oxford University Press 2007) at 644, particularly at fn 12, where *Comptroller of Stamps (Victoria) v Howard-Smith* (1936) 54 C.L.R. 614 at 622 is cited.

<sup>180</sup> *William Brandt's Sons & Co v Dunlop Rubber Co Ltd* [1905] A.C. 454 at 462 (H.L.) per Lord Macnaghten. The distinction between equitable and statutory assignments, referred to in the text as well as in the following note, is immaterial for the present discussion.

<sup>181</sup> The assignment of choses in action was first recognized by courts of equity. These courts 'admitted the title of an assignee of a debt, regarding it as a piece of property, an asset', *Fitzroy v Cave* [1905] 2 K.B. 364 at 372. This position gained a limited statutory recognition originally in s 25(6) of the *Supreme Court of Judicature Act 1873* (UK), 36 & 37 Vict., c. 66. The obligor is bound by the assignment upon receiving notice of it; *Stocks v Dobson* (1853) 4 De G.M. & G. 11, 43 E.R. 411 (Ch.). See eg B Geva, *Financing Consumer Sales and Product Defences* (Toronto: Carswell, 1984) at 47–50 (hereafter: Geva, *Financing*). In a payment mechanism, the communication of **Debtor's** order to **Paymaster** constitutes the required notice to the obligor.

<sup>182</sup> See, eg, *Tailby v The Official Receiver* (1888) 13 App. Cas. 523 at 546 (H.L.).

<sup>183</sup> Such may be the case, in modern banking practice, where **Paymaster** (a banker) provides **Debtor** (the customer) with an overdraft facility.

separate from the assignment of the debt, and is a matter between **Debtor** and **Paymaster**. In the absence of a third party beneficiary theory, such an agreement will not benefit **Creditor**.

The effect of **Paymaster's** subsequent assent to carry out **Debtor's** instructions will now be considered. Indeed, having received **Debtor's** instructions, whether or not required to abide by them, **Paymaster** may well indicate his assent to carry them out. **Paymaster's** assent is likely to be binding as against **Debtor**.<sup>184</sup> However, in the absence of a third party beneficiary theory, or unless it forms a direct agreement between **Paymaster** and **Creditor**, **Paymaster's** assent does not furnish **Creditor** with rights towards **Paymaster**. The assent does not entitle **Creditor** as against **Paymaster**, to recover from **Paymaster**. Thus, by itself, and in the absence of a third party beneficiary theory or a direct agreement between **Paymaster** and **Creditor** arising from **Paymaster's** assent, **Paymaster's** assent to carry out **Debtor's** instructions does not advance **Creditor's** position where **Creditor** is not entitled against **Paymaster** on the basis of **Debtor's** order alone.

The assignment by **Debtor** to **Creditor** of an existing and immediately payable debt owed by **Paymaster** to **Debtor** is thus the only theory under which **Debtor's** payment order, by itself, requires **Paymaster**, against **Debtor** as well as against **Creditor**, to pay **Creditor** immediately. Nevertheless, whenever there is no such assignment, if because the law regards **Debtor's** instructions as a mere mandate falling short of an assignment, or because at the time the order is to be carried out there is no existing and immediately payable debt owed by **Paymaster** to **Debtor**, **Paymaster** may be bound towards **Debtor**, either under a previous agreement or under a subsequent assent. On **Creditor's** part, where **Creditor** is not the assignee of an existing and immediately payable debt owed by **Paymaster** to **Debtor**, **Creditor** has no immediate grounds for a right against **Paymaster** to recover from **Paymaster** on demand. In general, such a right cannot be derived from **Debtor's** bare order to **Paymaster**, from **Debtor** and **Paymaster's** previous agreement, or from **Paymaster's** subsequent assent to carry out **Debtor's** instructions.

Nonetheless, there are circumstances where such a right to recover from **Paymaster** could be conferred upon **Creditor** on the basis of **Paymaster's** agreement or assent, and even in the absence of the assignment of an existing and immediately payable debt. First, if any third party beneficiary theory applies, **Paymaster's** previous agreement with **Debtor** or subsequent assent to carry out **Debtor's** instructions may inure to the benefit of **Creditor**. Second, under some circumstances, **Paymaster's** assent may be viewed as forming a direct agreement with **Creditor**, binding **Paymaster** towards **Creditor**.

In sum, in the absence of the assignment of an existing and immediately payable debt owed by **Paymaster** to **Debtor**, the bare order of **Debtor** to **Paymaster** to pay **Creditor** does not bind **Paymaster** against **Debtor** as well as against **Creditor**. However, in the absence of such an assignment, a previous agreement

<sup>184</sup> Provided all the requisite elements for a binding contract have been fulfilled.

between **Debtor** and **Paymaster**, as well as a subsequent assent by **Paymaster**, may bind **Paymaster** towards **Debtor**. Under some circumstances, such an agreement or assent may also bind **Paymaster** towards **Creditor**. Those circumstances occur where either the application or a third party beneficiary theory, or the existence of a direct contract between **Paymaster** and **Creditor** arising from **Paymaster's** assent, is warranted.

*Second Issue: Scope of Creditor's Entitlement* This takes us to the third question raised in connection with the second issue: if **Creditor** is entitled as against **Paymaster**, what is the scope of his entitlement? Can **Creditor** recover from **Paymaster**, free from:

- (i) **Paymaster's** defences against **Debtor**,
- (ii) **Debtor's** defences against **Creditor**, as well as,
- (iii) a third party's adverse claims?

Under the assignment theory, **Paymaster** is to become liable to **Creditor** on the debt owed by **Paymaster** to **Debtor**. It thus appears to follow that **Paymaster** may raise against **Creditor** defences available to **Paymaster** against **Debtor**, but not defences available to **Debtor** against **Creditor**. Conversely, under the assent theory, **Paymaster** may appear to become liable to **Creditor** on the debt due from **Debtor** to **Creditor**, in which case, defences available to **Debtor** on that debt, and not on **Debtor's** debt to **Creditor**, ought to be at the disposal of the **Paymaster**.

Nevertheless, in each case, whether **Creditor's** right against **Paymaster** is based on **Debtor's** assignment or on **Paymaster's** assent or agreement with **Debtor**, no answer to that question is immediately available. Where **Creditor** is regarded as **Debtor's** assignee, **Creditor** takes the debt owed by **Paymaster** to **Debtor** subject to its equities, including **Paymaster's** defences towards **Debtor**,<sup>185</sup> except that the terms of **Paymaster's** indebtedness to **Debtor** may call for full payment to an assignee notwithstanding such equities.<sup>186</sup> Likewise, whether an assignment from **Debtor** to **Creditor** for value cannot be retracted upon **Creditor's** failure to provide **Debtor** with the agreed value depends on the terms of the assignment, the treatment by law of its nature, or the extent of **Creditor's** breach, that is, of **Creditor's** failure to supply **Debtor** with the agreed value. Upon the successful retraction of his assignment on the basis of his defences towards **Creditor**, **Debtor** may effectively prevent **Creditor** from recovering from **Paymaster**.

Alternatively, **Creditor's** right against **Paymaster** may be founded on **Paymaster's** assent or agreement. The scope of **Creditor's** entitlement will depend then on the terms of this assent or agreement. Indeed, **Paymaster** may agree to pay **Creditor** either unconditionally and irrevocably, or subject to **Debtor's** right against **Paymaster**, or **Creditor's** right against **Debtor**. In the

<sup>185</sup> See in general Geva, *Financing*, above n 181 at 47–62.

<sup>186</sup> See in general Geva, *ibid* at 93–101.

former case, where **Paymaster** unconditionally and irrevocably agrees to pay **Creditor**, **Paymaster** in fact commits himself in **Creditor's** hands. Under the mere mandate theory, only then may **Creditor** recover from **Paymaster** free from **Paymaster's** defences against **Debtor**, as well as from **Debtor's** defences towards **Creditor**.

It is evident that **Creditor's** freedom from **Paymaster's** defences against **Debtor** is crucial to the effective operation of any payment mechanism, particularly if **Debtor** is discharged from his debt to **Creditor** prior to full payment by **Paymaster** to **Creditor**. As for **Creditor's** freedom from **Debtor's** defences, or conversely, as to the question of whether **Debtor** can effectively prevent **Paymaster** from paying **Creditor** on the basis of **Debtor's** defences against **Creditor**, policy considerations are quite equivocal. Applicable policies have to accommodate the two defensible but conflicting viewpoints of **Debtor** and **Creditor**.

Thus, **Creditor** is concerned with the credibility of the payment mechanism, or with its being a viable substitute to payment in cash. **Paymaster** is an intermediary, ready and willing to pay **Creditor**, provided that such payment be authorized, namely, that thereby **Paymaster** will either be discharged from his debt to **Debtor**, or be entitled to recover from **Debtor**. **Debtor**, however, is concerned with maximizing his enforcement position against a breaching party **Creditor**. Indeed, an authorized payment by **Paymaster** to **Creditor** either discharges **Paymaster's** liability to **Debtor**, or charges **Debtor** with liability to **Paymaster**. As such, from **Debtor's** perspective, an authorized payment by **Paymaster** to **Creditor** has the same effect as cash payment by **Debtor** to **Creditor**. From **Debtor's** viewpoint, the issue is then **Debtor's** ability to prevent a breaching party (**Creditor**) from having the benefit of actual payment.

**Creditor's** power to defeat adverse claims to his entitlement against **Paymaster** is adequately explained within the framework of **Debtor's** assignment as well as of **Paymaster's** assent. Thus, **Debtor** may give **Paymaster** money that may be stolen or subject to trust, so as to give rise to a third party's adverse claim. **Paymaster's** debt to **Debtor**, incurred by the delivery of the money by **Debtor** to **Paymaster**, becomes the proceeds of that money.<sup>187</sup> As such, the debt may be traced by the original owner of the money.<sup>188</sup> Following **Debtor's** payment instructions, this debt is either transferred to **Creditor** ('assignment' theory) or extinguished and transferred to proceeds in the form of another debt owed by

<sup>187</sup> For proceeds as the original property in a changed form upon a disposition or other transformation, see eg *Taylor v Plumer* (1815) 3 M. & S. 562, 105 E.R. 721 (K.B.). For debts as proceeds of merchandise sold, see *Scott v Surman* (1742) Willes 400, 125 E.R. 1235 (C.P.). For a banker's debt as proceeds of money deposited with him see B Geva, 'Authority of Sale and Privity of Contract: The Proprietary Basis of the Right to the Proceeds of Sale at Common Law' (1979-), 25 *McGill Law Journal* 32 at 55-56.

<sup>188</sup> Tracing was defined as 'following an asset into the hands of a transferee[,], following it into its proceeds[,], [or] a combination of these - that is, following the proceeds of disposition of an asset into the hands of a transferee of the proceeds.' DR Klinck, "'Two Distincts, Division None': Tracing Money into (and out of) Mixed Accounts' (1987-88), 2 *Banking and Finance Law Review* 147 at 150.



**Paymaster** to **Creditor**<sup>189</sup> ('assent' theory). Either way, **Creditor** becomes the holder of the proceeds of the original owner's money in the form of **Paymaster's** debt to **Creditor**. In principle, the original owner may follow ('trace') the money into its proceeds even where they are held by a third party.<sup>190</sup> Nevertheless, the right to trace proceeds into the hands of a third party is defeated where the latter has given value for the proceeds in good faith and without notice of the adverse claim.<sup>191</sup> Consequently, in the usual case, where **Creditor** complies with these requirements, his entitlement from **Paymaster** is beyond the reach of the original owner of the money.

In effect, this is an extension of the doctrine of currency to protect **Creditor**, not exclusively as a recipient of coins and banknotes from **Paymaster**,<sup>192</sup> but also as a holder of a claim against **Paymaster**.<sup>193</sup>

*Third Issue: Debtor's Discharge* The third legal issue arising in the course of the operation of a three party payment mechanism is the time of **Debtor's** discharge towards **Creditor**.<sup>194</sup>

Needless to say, full payment by **Paymaster** discharges the debt owed by **Debtor** to **Creditor**. Under the mandate theory, **Paymaster's** payment is to be treated as **Debtor's** payment, which inevitably leads to **Debtor's** discharge. Under the assignment theory, **Paymaster's** payment to **Creditor** primarily discharges the assigned debt, namely **Paymaster's** debt to **Debtor**. Yet, the agreement between **Debtor** and **Creditor** must have provided, explicitly or implicitly, that the effect of **Paymaster's** payment is also to discharge **Debtor's** debt to

<sup>189</sup> 'Proceeds' may also be derived indirectly from an original asset. Cf definition in s 1 'proceeds' of the Ontario *Personal Property Security Act*, RSO 1990, c. P.10.

<sup>190</sup> Cf eg *Banque Belge Pour L'Etranger v Hambrouck* [1921] 1 K.B. 321 (C.A.). Simplified for our purpose, the facts can be set out as follows: H ('**Debtor**') misappropriated money from Banque Belge ('**Original Owner**'), deposited it in his account at Farrow's Bank ('**Paymaster**'), and subsequently made payment (by way of gift) from it to his mistress S ('**Creditor**'). Banque Belge won in its action against S who had given no value for the money. For a similar explanation to the case, see S Khurshid and P Matthews, 'Tracing Confusion' (1979), 95 *LQR* 78, 91–94.

<sup>191</sup> The modern view is that to reach intangible proceeds, an original owner must invoke the assistance of equity. See eg RM Goode, *Proprietary Rights and Insolvency in Sales Transactions* (London: Sweet & Maxwell, Centre for Commercial Law Studies, 1985) at 80–81 and authorities cited there. The equitable nature of the proceeds claimant's right explains its subordination to a bona fide third party who gave value. Having not given value, the third party, S, was therefore defeated in *Banque Belge*, *ibid*. For the subjection of the tracing claimant's 'equitable proprietary interest' in a mixed fund to a bona fide purchaser for value, see RH Maudsley, 'Proprietary Remedies for the Recovery of Money' (1959), 75 *LQR* 234 at 239, fn30, and authorities cited there.

<sup>192</sup> In its more traditional sense, the doctrine protects a recipient in good faith and for value of stolen money. See ch 2, section 2.4 and ch 11, section 6.2 below.

<sup>193</sup> Cf *Thomson v Clydesdale Bank Ltd* [1893] A.C. 282 at 287 (H.L.) where a banker ('**Paymaster**') who had applied the deposit of misappropriated funds in payment to himself (thereby becoming '**Creditor**') was held to be immune from the original owner's claim. Cf the suggestion that 'for tracing purposes it is permissible to reify a banking account and to subject a transfer of funds to the same principles as to a transfer of money.' JS Ziegel, 'Tracing of Proceeds Under the Ontario Personal Property Security Act: *General Motors Acceptance Corp. of Canada, Ltd. v. Bank of Nova Scotia*' (1987–88), 13 *Canadian Business Law Journal* 177, 193. In our context, this 'reification' will insulate **Creditor** from adverse claims to his entitlement from **Correspondent**.

<sup>194</sup> The issues and questions are enumerated in the opening part of this subsection.



**Creditor.** In fact, **Debtor's** discharge towards **Creditor** must have been the value received by **Debtor** in return for the assignment to **Creditor** of **Paymaster's** debt.

Whether **Debtor's** debt to **Creditor** is discharged prior to full payment by **Paymaster** to **Creditor**, as well as the extent of **Debtor's** liability to **Creditor** prior to **Debtor's** discharge towards **Creditor**, are matters to be agreed upon between **Debtor** and **Creditor**, irrespective of the characterization of **Debtor's** payment order as a mere mandate or an assignment. In practical terms, **Creditor** is unlikely to discharge **Debtor** prior to full payment, unless and until **Creditor** is entitled, as against **Paymaster**, to recover from **Paymaster** the entire amount of **Debtor's** indebtedness. Possibly, however, **Debtor** may remain liable to **Creditor** throughout, until full payment. In other words, **Debtor's** liability will run concurrent with **Paymaster's**, until **Creditor** is paid by either **Debtor** or **Paymaster**. In such a case, one of them is a surety or guarantor to the other.

Alternatively, **Paymaster's** liability to **Creditor** may serve as either a conditional or absolute discharge of **Debtor's** liability to **Creditor**. Where it serves as a conditional discharge, **Debtor's** liability to **Creditor** is suspended when **Paymaster** becomes liable to **Creditor** and revives only if and when **Paymaster** defaults. Otherwise, where **Paymaster's** liability to **Creditor** serves as an absolute discharge of **Debtor's** liability to **Creditor**, **Debtor** is discharged altogether with respect to **Creditor** at the moment **Paymaster** becomes liable to **Creditor**.

Indeed, before releasing **Debtor**, **Creditor** must be convinced that **Paymaster's** solvency and credibility are undisputed. The general presumption is thus likely to be that of conditional discharge.<sup>195</sup> On the other hand, a **Debtor** who prepaid **Paymaster** is unlikely to agree to remain liable to a **Creditor** who agreed to become entitled to recover from **Paymaster**.<sup>196</sup>

In any event, the agreement between **Debtor** and **Creditor** as to **Debtor's** liability and discharge is not dependent on the terms of **Debtor's** payment order or on **Paymaster's** assent or agreement. Rather, it is a separate agreement between **Debtor** and **Creditor**.

*Fourth Issue: Paymaster's Discharge* Finally, the fourth issue is concerned with **Paymaster's** indebtedness to or entitlement to payment from **Debtor**. As indicated,<sup>197</sup> under the assignment theory, **Paymaster's** payment to **Creditor** is payment of **Paymaster's** debt to **Debtor**. As such, it discharges **Paymaster** towards **Debtor**. Under the mandate theory, **Paymaster's** payment to **Creditor** is that of **Debtor's** debt to **Creditor**. As such, it does not automatically discharge

<sup>195</sup> *In re Charge Card Services Ltd* [1988] 3 All E.R. 702 at 707.

<sup>196</sup> This may explain the absolute discharge presumption in the (usually prepaid) bank draft and similar negotiable instruments signed by banks (see eg §3-310(a) of the American *Uniform Commercial Code*) and the conditional discharge presumption in the (usually not prepaid) letter of credit (see eg §2-325 of the American *Uniform Commercial Code* and *WJ Alan & Co Ltd v El Nasr Export and Import Co* [1972] 2 All E.R. 127 at 139 (C.A.)). For the difference between pre-paid instruments (eg bank drafts, money orders and certified cheques) and credit facilities (eg the letter of credit) see in general: B Geva, 'Insolvent Bank's Irrevocable Credit as Priority Payment Instrument: *Barclays Bank v. Price Waterhouse*' (2000), 15 *Banking and Finance Law Review* 351.

<sup>197</sup> See section 4.2(ii) above.

**Paymaster's debt to Debtor.** Yet, **Paymaster's** agreement or assent must have provided, explicitly or implicitly, that **Paymaster's** payment to **Creditor** will result in discharging **Paymaster's** indebtedness to **Debtor**. Actual payment by **Paymaster** to **Creditor** thus results in **Paymaster's** discharge towards **Debtor**.

Whether **Paymaster's** debt to **Debtor** is discharged prior to **Paymaster's** full payment to **Creditor** is again a matter of agreement, this time between **Paymaster** and **Debtor**. Naturally, **Debtor** is not likely to agree with **Paymaster** on an early discharge of **Paymaster**, prior to full payment, unless **Debtor** is assured of obtaining discharge from **Creditor** not later than at that very point in time. Yet, in theory, the questions of **Paymaster's** discharge towards **Debtor**, and of **Debtor's** discharge towards **Creditor**, are separate. The former depends on the **Paymaster-Debtor** agreement. The answer to the latter depends on the agreement between **Debtor** and **Creditor**.

*Discharge: Summary* In summary, it is very likely that **Debtor's** discharge towards **Creditor** will coincide with **Paymaster's** discharge towards **Debtor**. Both may happen simultaneously with the accrual of **Creditor's** right as against **Paymaster**. Yet, in the final analysis, as a matter of legal doctrine, **Debtor's** discharge towards **Creditor**, **Paymaster's** discharge towards **Creditor**, **Paymaster's** discharge towards **Debtor**, and whether each occurs upon the accrual of **Creditor's** right against **Paymaster**, constitute three separate issues.

### *(iii) Four-party Money-transmitter Payment Mechanisms*

The operation of four-party money-transmitter payment mechanisms<sup>198</sup> raises seven legal issues which are enumerated as follows:

1. **Paymaster's** duty towards **Debtor**;
2. **Creditor's** right against **Paymaster**;
3. **Correspondent's** duty towards **Paymaster**;
4. **Creditor's** right against **Correspondent**;
5. **Debtor's** liability and discharge towards **Creditor**;
6. **Paymaster's** discharge towards, or debt from, **Debtor**; and
7. **Correspondent's** discharge towards, or debt from, **Paymaster**.

The first two issues are identical to those existing under a three-party mechanism and will not be elaborated on. The only variation however, is the responsibility to **Debtor** for acts or omissions of **Correspondent**; is the latter directly responsible to **Debtor**? Is **Paymaster** vicariously liable to **Debtor** for acts or omissions of **Correspondent**? To a large extent, and in the absence of governing specific legislation, the answer depends on applicable agency law.

The third issue, concerning **Correspondent's** duty towards **Paymaster**, is analogous to the issue regarding **Paymaster's** duty towards **Debtor**. It is con-

<sup>198</sup> Discussed in section 4.1(iii) above.

cerned with the basis of **Correspondent's** duty towards **Paymaster**, the manner in which it is put into force, and the result of its breach by **Correspondent**.

The fourth issue, namely **Creditor's** right against **Correspondent**, is analogous to the subject of **Creditor's** right against **Paymaster**. Three questions arise in this respect:

- (a) Is **Creditor** entitled to recover from **Correspondent**?
- (b) If yes, is it upon **Paymaster's** instructions to **Correspondent**, upon **Correspondent's** assent thereto, or upon the notification to **Creditor** of any of the above? Finally,
- (c) If **Creditor** is entitled to recover from **Correspondent**, what is the scope of **Creditor's** entitlement? Is it subject to:
  - **Correspondent's** defences against **Paymaster**?
  - **Debtor's** defences against **Creditor**?
  - Third party's adverse claims?

There is also an additional question which does not exist in a three-party payment mechanism: what is the relationship between **Creditor's** right against **Correspondent** and **Creditor's** right against **Paymaster**?

The fifth issue is concerned with **Debtor's** discharge against **Creditor**. Is **Debtor** discharged upon the occurrence of any of the events enumerated under the third issue discussed in connection with the operation of a three-party payment mechanism? These events were:<sup>199</sup>

- (a) **Debtor's** instructions,
- (b) **Debtor's** instructions to **Paymaster**, who is indebted to **Debtor** at that time,
- (c) **Paymaster's** assent,
- (d) the notification of **Creditor** of any of the above, or
- (e) actual payment to **Creditor**.

Alternatively, is **Debtor** discharged upon:

- (a) **Paymaster's** instructions to **Correspondent**,
- (b) **Paymaster's** instructions to **Correspondent** who is indebted to **Paymaster** at that time,
- (c) **Correspondent's** assent to carry out **Paymaster's** instructions, or
- (d) the notification to **Creditor** of any of the foregoing?

Ultimately, prior to **Debtor's** discharge, has **Debtor** incurred liability to **Creditor** for **Paymaster's**, **Correspondent's** or both **Paymaster's** and **Correspondent's** performance? If yes, when does this liability originate and what is its relationship with:

- (i) **Debtor's** original debt to **Creditor**;
- (ii) **Paymaster's** liability to **Creditor**; and
- (iii) **Correspondent's** liability to **Creditor**?

<sup>199</sup> See section 4.2(ii) above.

*The sixth and seventh issues* raise questions similar to those raised in connection with the fourth issue of the three-party payment mechanisms. Is either **Paymaster's** position towards **Debtor**, or **Correspondent's** position towards **Paymaster**, linked to **Debtor's** discharge towards **Creditor**? If no, which particular event, from all those enumerated in the preceding paragraph, determines **Paymaster's** position towards **Debtor**, and **Correspondent's** position towards **Paymaster**?

As was already stated, a four-party money-transmitter payment mechanism consists of two separate but related three-party systems.<sup>200</sup> Indeed, the problems arising in connection with the money-transmitter mechanism are of the same nature as those arising under the three-party mechanism. In the four-party context, these problems are nonetheless amplified to accommodate the additional operational or factual complexities. Overall, these problems lack sufficient conceptual distinctiveness. For this reason, no further analysis of legal issues is required at this point.

#### *(iv) Four-party Banker Payment Mechanisms*

As was previously noted, a four-party banker payment mechanism, such as cheque collection or GIRO payment system, whether for a debit or credit transfer, is actually an expanded three-party mechanism, with **Creditor's Banker** forming **Creditor's** extension or long arm.<sup>201</sup> In effect, it is a process designed 'to transfer an amount standing to the credit of [**Debtor**] . . . to the credit of [**Creditor's**] account.'<sup>202</sup>

In principle, a four-party banker payment mechanism gives rise to the same issues as the three-party payment mechanism. These were enumerated above at the beginning of section 4.2(ii) as:

1. **Paymaster's** duty towards **Debtor**;
2. **Creditor's** right against **Paymaster**;
3. **Debtor's** liability and discharge towards **Creditor**; and
4. **Paymaster's** discharge towards, or debt owed, by **Debtor**.

To a large extent, the previous discussion in section 4.2(ii), applicable generally to the three-party payment mechanisms, applies also to four-party banker payment mechanisms. Thus, other than under an assignment or a third-party beneficiary theory, it appears to be accepted that in a four-party banker payment mechanism, requiring **Debtor** to pay into **Creditor's** bank account, **Creditor** is not to become entitled against **Paymaster** so that the *second issue* is resolved quickly. As well, there is no added dimension in discussing the *fourth issue*; that of **Paymaster's** discharge towards, or debt owed by, **Debtor**. Similarly, discussion

<sup>200</sup> See section 4.1(iii) above.

<sup>201</sup> *Ibid.*

<sup>202</sup> *Royal Products v Midland Bank* (1981) 2 Lloyd's Rep. 194 at 198 (Q.B.D.) (though the statement was specifically made in connection with credit transfers).

of the *first issue* is almost the same as the discussion under any other three-party payment mechanism; the only additional dimension is the responsibility to **Debtor** for acts or omissions of an intermediary banker, where needed. Stated otherwise, the additional question raised is who is liable to **Debtor** for acts or omissions of an intermediary banker. Is it the intermediary banker himself? Alternatively, is **Paymaster** vicariously liable to **Debtor** for the intermediary banker's acts or omissions? The answer is the same as in connection with a four-party money transmitter payment mechanism; to a large extent, and in the absence of governing specific legislation, it depends on applicable agency law.<sup>203</sup>

A unique dimension nevertheless appears in connection with the *third issue*, that of **Debtor's** discharge towards **Creditor**. Thus, the process involved in a four-party banker payment mechanism is fundamentally that of substitution of **Debtor's** original debt to **Creditor** by a new debt of **Creditor's Banker** to **Creditor**. The key to the **Debtor's** discharge towards **Creditor** is thus the accrual of the debt owed by **Creditor's Banker** to **Creditor**, so as to replace **Debtor's** debt to **Creditor**. For example, the contract between **Debtor** and **Creditor** may require the former to make payment in cash to a designated bank account. This contract term is understood to allow **Debtor** to use 'any commercially recognised method of transferring funds, the result of which is to give the transferee [**Creditor**] the unconditional right to the immediate use of the funds transferred.'<sup>204</sup> This would constitute 'payment' in the same way as 'handing coins or banknotes' to the transferee's bank would constitute payment to the transferee/**Creditor**.<sup>205</sup>

The exact point of time for such unconditional, namely, 'unrestricted and unfettered',<sup>206</sup> right to the immediate use of the funds, to accrue in **Creditor's** favour against **Creditor's Banker**, so as to replace altogether **Debtor's** original debt to him, is determined under the rules governing the particular payment mechanism, mostly, depending on whether it is a debit or credit transfer.<sup>207</sup>

In principle, in a debit transfer, this point of time coincides with the irreversibility of the debit to **Debtor's** account on the books of **Debtor's Banker**. At that point in time, **Debtor's Banker** becomes accountable to **Creditor's Banker** who, in turn, becomes indebted to **Creditor**. At the same time, in a credit transfer, **Debtor's** debt to **Creditor** is discharged when **Creditor's Banker** becomes irrevocably indebted to **Creditor**. In general, the occurrence of such an irrevocable engagement to **Creditor** is associated with the acceptance by **Creditor's Banker**

<sup>203</sup> See section 4.2(iii) above (first issue).

<sup>204</sup> *The Brimnes Tenax Steamship Co Ltd v The Brimnes (Owners)* [1973] 1 All E.R. 769 at 782 (Q.B.), aff'd on that point, [1974] 3 All E.R. 88 (C.A.).

<sup>205</sup> *Mardorf Peach & Co v Attica Sea Carriers Corp of Liberia (The Laconia)* (1976) 2 All E.R. 249 at 257 (appeal taken from Q.B.D.), rev'd, (1977) 1 All E.R. 545 (H.L.) (explaining that '[n]owadays financial obligations . . . are not normally discharged by handing over coins or bank notes.').

<sup>206</sup> The expression is taken from *A/S Atwilco v Fulvia SPA di Navigazione (The Chikuma)* (1981) 1 Lloyd's Rep. 371 at 375 (H.L.).

<sup>207</sup> For the distinction, see section 4.1(ii) above.

of payment from the participant who instructed him to pay **Creditor**. In a multilateral inter-bank clearing setting, clearing rules determine the time such payment to **Creditor's Banker** occurs. Alternatively, in a bilateral setting, **Creditor's Banker** accepts payment by either (i) debiting the account of the participant who instructed him to pay **Creditor**, or (ii) having consented to a credit posted to his own account with a banker, typically, the one who instructed **Creditor's Banker** to pay **Creditor**.<sup>208</sup>

A unique *fifth issue* arises in a four-party banker payment mechanism involving a debit transfer in which intermediary bankers are involved on behalf of **Creditor's Banker** in the collection process.<sup>209</sup> The additional issue is the responsibility to **Creditor** for acts or omissions of an intermediary banker; is the latter directly responsible to **Creditor**? Is **Creditor's Banker** vicariously liable for **Creditor**? Analysis is analogous to that given above at the beginning of this subsection for the first issue, in connection with the employment of intermediary bankers by **Paymaster**; the answer thus mainly depends on applicable agency law.

#### 4.3 Conclusion

A payment mechanism is a form of machinery facilitating the transmission of monetary value in payment of debts that enables a debtor to avoid the transportation of banknotes and coins and their physical delivery to his creditor. Thereunder, the debtor instructs a third party, frequently his own debtor, to pay the creditor in discharge of the debt. The third party is likely to be a lender, banker, money-transmitter, or a fellow merchant having an ongoing business relationship with the debtor. The operation of the payment mechanism does not involve the physical delivery of a bag of money from the debtor to the creditor via a third party carrier. Rather, the third party pays out of his own pocket, thereby either discharging his own debt to the debtor, or becoming the debtor's creditor for the sum paid. Payment by the third party need not be in specie but could take place by the third party becoming indebted to the creditor in lieu of the original debtor.

This model is sufficiently elastic to accommodate all machineries for the transmission of monetary value, whether they are paper-based or electronic funds transfers, whether debit or credit transfers, whether paper currency or GIRO systems, and regardless of the stage of technological progress. The model is also sufficiently broad to accommodate multiparty payment mechanisms using more intermediaries, besides the third party, for the transmission of monetary value.

<sup>208</sup> On this subject, in connection with both debit and credit transfers, see in general B Geva, 'Payment Finality and Discharge in Funds Transfers' (2008), 83 *Chicago-Kent Law Review* 633.

<sup>209</sup> Discussed in section 4.1(iii) above.

While each payment mechanism might have distinct features, the very term ‘payment mechanism’ in its generality attests to the existence of common elements. Notwithstanding the various forms and techniques for the transmission of monetary value, ‘payment mechanism’ is susceptible to analysis as a single legal concept, embracing the totality of machineries for the transmission of monetary value and forming the common denominator among legal doctrines applicable to them. To what extent this perspective ought to be implemented to create uniformity of rules is fiercely debated;<sup>210</sup> regardless, this perspective justifies a cohesive and single framework for analysing common issues from an historical point of view, which is the goal of the present study.

#### 4.4 Addendum: Payment by Paymaster’s Obligation and the Evolution of Modern Payment Mechanisms

Certainly, the entitlement to enforce **Paymaster’s** obligation provides comfort to **Creditor**. This section presents a brief conceptual analysis outlining an evolutionary development of various modern payment mechanisms giving **Creditor** such comfort. The discussion focuses on legal aspects outlined throughout this chapter with the view of validating its analysis and underlying theme.

The following discussion sets out salient features of each mechanism and its improvements upon, that is, its enhancements of, those features of its predecessor. Indeed, this is not an historical discussion of the origins of each payment mechanism; equally, a comprehensive discussion of the law governing each of the various mechanisms is beyond the scope of the present account. Rather, this account is limited to a brief outline of the evolutionary development of various payment mechanisms giving **Creditor** the comfort of an entitlement to enforce **Paymaster’s** obligation. In effect, this account provides a framework for rationalizing advantages, drawbacks, and reasons for either growth or decline of various mechanisms.

Most notably, in modern law, the comfort of an entitlement to enforce **Paymaster’s** obligation is given to the beneficiary of a letter of credit, the holder of a bank cheque, a merchant paid by credit or debit card, and one paid by a stored-value card. At the same time, such comfort is given to **Creditor** neither in GIRO debit and credit transfer nor in cheque systems. In those latter systems, **Debtor’s** banker acts as **Paymaster**, whose obligation towards **Debtor**, nevertheless, does not inure to the benefit of **Creditor**.

<sup>210</sup> Contrast HS Scott, *New Payment Systems: A Report to the 3-4-8 Committee of the Permanent Editorial Board for the Uniform Commercial Code* (Philadelphia: Executive Office PEB UCC, 1978) who argues at 252 for the merit of ‘a set of comprehensive rules applicable in some respects to all payment systems’, with CP Gillette and SD Walt, ‘Uniformity and Diversity in Payment Systems’ (2008), 83 *Chicago-Kent Law Review* 499.



Thus, for example, the *cheque* is a written unconditional order to pay, signed by a ‘drawer’, and addressed to his banker (‘drawee’).<sup>211</sup> It is issued by the ‘drawer’ to the payee who takes it as its first ‘holder’; it may usually be transferred from one holder to another by negotiation, that is, by the delivery of the holder with or without his endorsement.<sup>212</sup> In this process, drawer is **Debtor**, payee is **Creditor** and banker is **Paymaster**. The cheque is paid by **Paymaster** upon its presentment by the holder, who usually acts through his own banker; in turn, the holder’s banker may entrust one or more bankers to act for him in the process. A cheque is not debited to the drawer’s account upon its issue, but rather, in response to its presentment by the holder. As a mechanism for collection by the holder from the drawer’s account, the cheque generates a debit transfer. A payee to whom a cheque is issued is not guaranteed payment and is faced with the risk of dishonour for lack of cover or any other reason.<sup>213</sup> Stated otherwise, **Paymaster**-drawee ordered by **Debtor**-drawer is not obligated towards **Creditor**-payee; rather, he is contractually bound to pay the payee only vis-à-vis **Debtor**-drawer.

Conversely, the *letter of credit* is an undertaking of an issuing banker to pay a beneficiary upon the presentment by the beneficiary of complying documents, specified in the letter of credit. It is issued by the issuing banker upon the application of its customer, known to be an account-party or applicant, in fulfilment of the account-party/applicant’s obligation to the beneficiary. Its issue by the issuing banker to the beneficiary is taken to be an engagement of the issuing banker which is enforceable by the beneficiary. The letter of credit may be ‘advised’ or even ‘confirmed’ by a banker to the beneficiary. As a rule, the ‘confirmation’ of the letter of credit is given by a correspondent of the issuing banker; it amounts to an additional obligation on the letter of credit, also running in the beneficiary’s favour.<sup>214</sup> In terms of the preceding analysis of this chapter, the confirmed, or even merely advised, letter of credit is a four-party transmitter payment mechanism.

In the letter of credit setting, the issuing banker acts as **Paymaster**, the beneficiary acts as **Creditor**, and the account party/applicant as **Debtor**. The advising or confirming banker is **Correspondent**. Hence, the letter of credit gives

<sup>211</sup> See definitions eg in s 73 of the *Bills of Exchange Act 1882* (UK), 45 & 46 Vict., c. 61 (as amended) (BEA); art 1 of Convention Providing a Uniform Law for Cheques, 19 March 1931, 143 L.N.T.S. 355, Annex I (ULC); and §3-104(f) of the *Uniform Commercial Code* art 3 (1990, as amended, 2002) (U.C.C.). The order to pay must be for a sum certain in money and the instrument ought to be payable on demand.

<sup>212</sup> BEA s 31; ULC art 14; U.C.C. §3-201, *ibid*.

<sup>213</sup> By itself, the issue of the cheque does not constitute a transfer of the cover to the payee, even when such a cover is available in the drawer’s account. See eg BEA s 53(1).

<sup>214</sup> Typically, parties to a letter of credit transaction adhere to rules reflecting uniform customary practices issued by the International Chamber of Commerce (ICC). These rules define relevant terms and provide for the respective roles, rights and duties of participants. The current version is UCP600 of 2006 (effective 1 July 2007). For a monumental, continuously updated treatise on letters of credit law see JF Dolan, *The Law of Letters of Credit: Commercial and Standby Credits*, 4th edn (Austin, TX: Pratt, 2007) [looseleaf].



**Creditor** the comfort of an entitlement to enforce **Paymaster's** obligation; in the case of a confirmed letter of credit, **Creditor** may also recover from **Correspondent**. Furthermore, under the law of letter of credit, and subject to a narrow fraud exception, the obligation on the letter of credit, whether of **Paymaster**, and where applicable of confirming **Correspondent** as well, is autonomous, hence free of defences available either to **Debtor** towards **Creditor** or to **Paymaster** towards **Debtor**.<sup>215</sup> However, it confers on **Debtor** a conditional and not absolute discharge towards **Creditor**; that is, in case of default by **Paymaster**, **Creditor** can recover from **Debtor**. In my view, this result is predicated on the fact that, generally speaking and in a typical letter of credit transaction, **Debtor**-account party/applicant does not prepay **Paymaster**-issuer, but rather obliges himself to reimburse him.<sup>216</sup>

The letter of credit is typically used in connection with the sale of goods between distant parties. Its issue is an elaborate banking procedure and it is thus unfit to fill in the gaps in the more standard and informal cheque transaction. Other alternatives have developed to ensure **Creditor's** entitlement to payment from **Paymaster**.

One such device has been the replacement of **Debtor's** cheque by a cheque on which **Paymaster** is directly liable to the payee-**Creditor**. Such device could be in the form of a **Debtor's** cheque certified by the drawee banker, a cheque drawn by a banker on itself, or a cheque drawn by a banker on another banker. The traveller's cheque also falls into this category. Each such instrument may be referred to as a '*banker's instrument*', so as to be distinguished from a 'personal cheque' on which a banker is not liable. According to the law of bills of exchange and cheques, and regardless of the characterization of a given device as a three- or multi-party payment mechanism,<sup>217</sup> the banker, as either a drawer or certifier, acts as **Paymaster** and is directly liable to the payee/holder.<sup>218</sup>

In contrast to the letter of credit, the taking of a banker's instrument may be deemed to be an absolute discharge of **Debtor's** obligation to **Creditor**;<sup>219</sup> indeed, this is consistent with its typically being a prepaid instrument, under which the banker is paid by **Debtor** prior to the issue of the instrument.<sup>220</sup> Under the law of bills of exchange and cheques, the banker's obligation may be considered autonomous, so as to be enforceable by its holder free of defences available to **Paymaster**-banker against **Debtor**. It may also be free of defences available to **Debtor** against **Creditor**. However, this conclusion is the result of a complex analysis under the law of bills of exchange and cheques. It is not as

<sup>215</sup> A leading case is *BNS v Angelica Whitewear* (1987) 36 D.L.R. (4th) 161 (SCC).

<sup>216</sup> As already pointed out in this chapter, at section 4.2(ii) above at n 196.

<sup>217</sup> Where **Paymaster** draws on a drawee bank, the latter is **Correspondent**, so that the facility is a four-party transmitter payment mechanism. However, like the drawee on a personal cheque, the drawee on a banker's instrument is not liable to the payee/holder.

<sup>218</sup> For banker's liability on a banker's instrument see in general B Geva, 'Irrevocability of Bank Drafts, Certified Cheques and Money Orders' (1986), 65 *Canadian Bar Review* 107.

<sup>219</sup> A statutory provision to that effect is U.C.C. §3-310(a) in the US.

<sup>220</sup> See reference in n 196 above.

straightforward as the conclusions that may be drawn under the law that governs letters of credit.<sup>221</sup>

In any event, a banker's instrument is typically prepared in advance. It is prepared prior to, albeit in anticipation of, the transaction giving rise to **Debtor's** payment obligation to **Creditor**. Thus, to protect the payee from the risk of dishonour in the case of a 'spontaneous', unplanned, face-to-face transaction, the *cheque guarantee card* was developed. This is an undertaking of the drawee banker, as an issuer-guarantor, to honour **Debtor's** personal cheques. In connection with each cheque issued under the guarantee, the drawee-guarantor's liability inures directly to the benefit of the payee. To benefit from the guarantee, the payee must have taken the cheque on the basis of the guarantee card presented to him at the time of the transaction. In the cheque guarantee transaction, the drawer is **Debtor**, the payee is **Creditor**, and the drawee/guarantor is **Paymaster**. In contrast to the case of the personal cheque used without the card, the **Paymaster** in a cheque guarantee payment is directly liable to the payee-**Creditor**. However, **Paymaster** is not liable on the cheque itself, as it would be in the case of the banker's instrument. At the same time, compared to the letter of credit, the guarantee is a secondary obligation; it neither discharges **Debtor** nor is autonomous, viz free of defences, in the hands of **Creditor**.<sup>222</sup> Furthermore, from a practical perspective, the cheque guarantee facility does not involve any communication to **Paymaster** at the time the cheque is issued. As such, it does not afford **Paymaster** meaningful protection from fraudulent use. Nor does it offer **Paymaster** any assurance of limited use within guarantee limits. Therefore, the cheque guarantee card can work only for small amounts.

Substantial improvements on the cheque guarantee card were introduced by payment cards.<sup>223</sup> Payment cards were developed outside the cheque system. The first to appear was the *credit card*. Unlike the cheque guarantee card, the credit card facilitates instant communication from the point of payment to **Paymaster** for authorization. This affords an immediate assurance of payment to the payee-**Creditor** by **Paymaster** who is able to verify both cover (or, more precisely, use within credit limits) and whether the card has been reported lost or stolen. Communication between payee-Merchant-**Creditor** and **Paymaster** was originally over the telephone; now it is electronic; from a terminal which 'reads' and passes on relevant information from the magnetic stripe on the card when it is swiped by the payee-Merchant-**Creditor** at the terminal. Authentication by the

<sup>221</sup> See in general, B Geva, 'The Autonomy of the Banker's Obligation on Bank Drafts and Certified Cheques' (1994), 73 *Canadian Bar Review* 21 at 21–56, and addendum at 280, as well as B Geva, 'Defences on Cheque Certification: *Esses v Friedberg*' (2009), 24 *Banking and Finance Law Review* 359.

<sup>222</sup> For the secondary obligation of the guarantor, and his release upon breach of the contract, see K McGuinness, *The Law of Guarantees*, 2nd edn (Toronto, Carswell, 1996) at 30–31, 565–66. Contrast with the autonomy of the letter of credit; see A Mugasha, *The Law of Letters of Credit and Bank Guarantees* (Annadale and Leichhardt, NSW: The Federation Press, 2003) at 136.

<sup>223</sup> See B Geva, 'Consumer Liability in Unauthorized Electronic Funds Transfers' (2003), 38 *Canadian Business Law Journal* 207 at 212–23.

Cardholder-Debtor has been by manual signature on a piece of paper which is, however, not a cheque.<sup>224</sup> Thus, without being able to receive on-line instant authentication from the Cardholder-Debtor, the Paymaster-card issuer is likely to debit a credit-line rather than an asset account of Debtor. The latter incurs interest and is to pay Paymaster on receipt of a periodical statement from Paymaster. At the same time, Creditor's banker is typically prepared to instantly credit the payee-Merchant-Creditor's account, albeit provisionally, pending dishonour or return ('chargeback') only on the basis of unauthorized use of the card. In the process, the sales slip signed by the Cardholder-buyer-payer-Debtor is not even processed; rather, it is kept by the payee-Merchant-Creditor in case the cardholder claims that the card was used without his authority.

The authentication of payment instructions by means of a secret code, such as a PIN, enables Paymaster to promptly, upon authorization, debit the buyer-Cardholder-Debtor's asset account. This is how the credit card evolved to a *debit card*, using the same magnetic stripe technology.<sup>225</sup>

The *stored-value card*<sup>226</sup> was developed to eliminate the need to communicate the payment instructions from the point of payment to Paymaster for authorization. Unlike credit and debit cards, which are access products facilitating access to value 'stored' in an account held with and operated by the Paymaster-banker, value in the stored-value card is stored and processed on the card itself. Authorization and transfer of value are thus performed on and from the card. This requires an enhanced and sophisticated technology; that of an integrated-circuit (IC) card containing a microprocessor chip ('electronic purse'), so as to turn the card into a 'smart card'.

The legal distinction between credit and debit card continues to turn on the access of the former to a credit line and of the latter to an asset account.<sup>227</sup> Thus, there is nothing to preclude a card relying on a PIN authentication, and even on a 'smart card' technology, from being linked to the access of a credit line, so as to be a credit card. In fact, with the view of enhancing security and reducing the production of fake cards, there is a growing tendency today towards the use of 'smart card' technology for all payment cards, regardless of whether a given card is an access or stored-value card, and irrespective of

<sup>224</sup> In practice, authorization can also be given by post, phone, or over the Internet. *Ibid.*

<sup>225</sup> See also B Geva, 'The E.F.T. Debit Card' (1989), 15 *Canadian Business Law Journal* 406.

<sup>226</sup> Not to be confused with the 'prepaid card' such as a gift, remittance or payroll card which is an access device, albeit not to the cardholder's account, but rather to a master account set up by the card provider (eg money transmitter, employer), allowing access for each card to the limits of the 'prepayment'. See eg B Geva, 'Recent International Developments in the Law of Negotiable Instruments and Payment and Settlement Systems' (2007), 42 *Texas International Law Journal* 685, 699–705.

<sup>227</sup> In the US, under federal law, the *Consumer Credit Cost Disclosure Act*, 15 U.S.C. §1631 (1968) (CCCD), and s 226.12 of *Regulation Z Truth in Lending*, 12 C.F.R. §226 (as amended) implementing it, govern a card accessing a credit plan, namely a credit card (defined in reg Z §226.2(a)(15)). For a debit card initiating an electronic fund transfer, see *Electronic Funds Transfer Act*, 15 U.S.C. §1693 (1978) (EFTA) and Regulation E 12 C.F.R. §205 (1981), (as amended) implementing it (particularly its s 205.3(b)).

whether, as an access card, it is used in connection with a credit line or an asset account. Still, the preceding analysis demonstrates the evolution of the payment card, providing **Creditor** with the right to claim from **Paymaster**, into various uses, in tandem with the advancement of technology.

A few observations regarding the law that governs payment cards are to be made as follows:

1. Clearing and settlement of payment card transactions may operate as either debit or credit transfers, which does not change the above analysis, under which salient legal aspects of the mechanisms focus on **Paymaster's** liability.
2. English case law characterizes payment by credit card as absolute payment.<sup>228</sup> However, the question arose and was settled in the case of a 'previous generation' credit card, in connection with which not only payment by the buyer-Cardholder-**Debtor** but also payment to the payee-Merchant-**Creditor**, was not instantaneous. In the facts of that case, Card Issuer-**Paymaster** became insolvent during the delay, that is, prior to both receiving and making payment. Under such circumstances, payee-Merchant-**Creditors** were not allowed to recover from buyer-Cardholder-**Debtors**; rather, the latter remained bound to pay **Paymaster** in whose liquidation process **Creditors** could prove their claims and collect dividends.<sup>229</sup> Arguably, the issue is at least less likely to arise in the case of an instantaneous payment from **Debtor** to **Creditor**, which is the prevailing practice in debit and stored-value cards.
3. Regardless of the above, at least in theory, there is a question as to the position of the Merchant-**Creditor's** banker. First, it is unclear whether the Merchant-**Creditor's** banker is liable to the payee-Merchant-**Creditor** on the same basis that a confirming banker is liable in a letter of credit transaction. An even more intriguing question is whether, notwithstanding the previous analysis, **Paymaster** is in fact liable only to the Merchant-**Creditor's** banker, so that the only party liable to the payee-Merchant-**Creditor** is the Merchant-**Creditor's** banker.<sup>230</sup> Stated otherwise, in a payment card transaction, **Creditor's** banker acts as **Correspondent**; it is not clear, however, whether **Creditor's** banker is liable to **Creditor** on the basis of **Paymaster's** obligation. If so, it is unclear whether **Creditor's** banker is liable in addition to, or in lieu of, the liability of **Paymaster**. The answer may vary according to the contractual and network rules governing each situation.
4. It was held in the United States that a credit-card issuer advances funds, and not an assignee of the contract for sale of the goods bought by means of the

<sup>228</sup> *In re Charge Card Services Ltd*, above n 195 at 710.

<sup>229</sup> Indeed, as in text referred to in n 196 above, prepayment is likely to lead to absolute discharge so as to avoid double payment by **Debtor**. However, as in *In re Charge Card Services Ltd*, *ibid*, due to other considerations, in some payment mechanisms, absolute discharge may be presumed even in the absence of prepayment. Certainly, under such circumstances, **Debtor** does not incur the risk of double payment.

<sup>230</sup> No Merchant-**Creditor's** banker was involved in *In re Charge Card Services Ltd*, *ibid*, which was a three-party credit card arrangement and hence does not provide any insight on these issues.

credit card.<sup>231</sup> Generally speaking, this would have supported an autonomous obligation of the Card Issuer-**Paymaster** towards the payee-Merchant-**Creditor**. The same analysis seems to apply to all payment cards. However, in many jurisdictions consumer protection policies interfered to override this result for credit cards.<sup>232</sup> At least so far, no such policies have been part of the discussion on the legal features of debit and stored-value cards so that the liability of its issuer is to be taken as autonomous.

<sup>231</sup> *Harris Trust and Savings Bank v McCray* (1974) 316 N.E. 2d 209 (Ill. App. Ct. 1974).

<sup>232</sup> In the US, the relevant federal statute is CCCDA, above n 226, and Regulation Z implementing it, *ibid* §1666i, §226.12(c).

## 2

# Money and Monetary Legal Theory in Antiquity and the Middle Ages

|                                                                                                                   |     |
|-------------------------------------------------------------------------------------------------------------------|-----|
| 1. Money in Antiquity and the Middle Ages                                                                         | 68  |
| 1.1 Overview                                                                                                      | 68  |
| 1.2 Origins                                                                                                       | 73  |
| 1.3 Expansion                                                                                                     | 81  |
| 1.4 Debasement and Transformation                                                                                 | 87  |
| 2. The Monetary Legal Theory under the Talmud                                                                     | 92  |
| 2.1 Introduction                                                                                                  | 92  |
| 2.2 Coins as Money and Ordinary Chattels: The Legal Nature of the<br>Money Change Transaction                     | 97  |
| 2.3 Coins valued on Basis of Metal: Effect of Erosion                                                             | 101 |
| (i) Introduction                                                                                                  | 101 |
| (ii) Deficient Coins as Money                                                                                     | 103 |
| (iii) Erosion to the Limit of Fraud                                                                               | 103 |
| (iv) Erosion Beyond the Limit of Fraud                                                                            | 105 |
| 2.4 Property Rules Applicable to Coins: Facilitating Circulation                                                  | 107 |
| 2.5 Conclusion                                                                                                    | 110 |
| 3. From Metallism to Nominalism: Evolution of Monetary Legal Theory<br>in Roman Law and the Common Law of England | 111 |
| 4. Concluding Remarks                                                                                             | 115 |

## 1. MONEY IN ANTIQUITY AND THE MIDDLE AGES

### 1.1 Overview

**T**HIS CHAPTER DEALS with the emergence and evolution of coined money in Antiquity and the Middle Ages. It is thus concerned with a process that shaped the development of the pertaining monetary legal theory throughout this era, particularly, from metallism to nominalism. Under the former, monetary objects, such as coins, are denominated and circulate by

reference to the weight of their metallic content. Under the latter, monetary objects, such as coins and banknotes, are denominated and circulate by reference to prescribed abstract units of account, as defined by law from time to time, regardless of the intrinsic value of the monetary objects themselves.<sup>1</sup>

In Antiquity and throughout the Middle Ages,<sup>2</sup> money consisted of coins. Indeed, as will be discussed below in chapter eight, section 2, ‘bank money’, in the sense of a credit balance held with a deposit-taking institution and transferable in whole or in part by payment order, originated in the late Middle Ages. However, even if contemporaries elevated ‘bank money’ to true money, which is doubtful, the emergence of ‘bank money’ in the late Medieval era was a stage in the evolution of payment mechanisms, ultimately leading to cheques and banknotes, and hence, better dealt with in subsequent chapters, particularly in chapter ten.

The coin of Antiquity and the Middle Ages was fundamentally a piece of metal, fashioned into a prescribed shape, usually circular,<sup>3</sup> with a prescribed weight and degree of fineness. It was stamped by the issuer with certain designs, marks and devices.<sup>4</sup> The coin’s purchasing power was by reference to units of account measuring the value in which the coin circulated. Under the metallic theory, which originated in Antiquity and survived one way or another throughout the Middle Ages,<sup>5</sup> those units were supposed<sup>6</sup> to reflect the weight, and hence the purchasing power, of the coin’s metallic content, so that ‘it is a truism to affirm that the value of a coin primarily depends on the value of its metal from which it consists, its quality, and its weight.’<sup>7</sup> Early coins tended to have designs on one side and punch marks on the other;<sup>8</sup> as of the fifth century BCE, designs had been fixed on both sides.<sup>9</sup> The Romans were the first to have a persistent policy of explicitly stating the denomination and hence the value of each coin upon its face.<sup>10</sup> Previously, ‘[f]or most part the Greeks allowed the size of

<sup>1</sup> The two concepts are further explained below in section 2.1.

<sup>2</sup> Roughly speaking, Antiquity comes to an end with the beginning of the Middle Ages, usually marked by the fall of Rome in 476 CE. The Middle Ages are commonly dated from the fifth century fall of the Western Roman Empire until the fall of the Eastern Roman Empire in the fifteenth century. But cf the opening paragraph of ch 8, section 1 below.

<sup>3</sup> Note however that ‘[c]oin, in French, signifieth a corner, and from thence hath its name, because in ancient times money was square’. See M Hale (d. 1676), *The History of the Pleas of the Crown*, 1st American edn by WA Stokes and E Ingersoll (Philadelphia: RH Small, 1847) vol 1 at 187, fn 2. While this may well be the origin of the word, the assertion as to the shape of coins in Antiquity is an exaggeration. Cf F Rebuffat, *La Monnaie dans l’Antiquité* (Paris: Picard, 1996) at 24 who speaks of the circular shape as traditional, though subject to exceptions, as eg square coins from India. For more on the shape of coins see G MacDonald, *The Evolution of Coinage* (Cambridge: University Press, 1916) at 57–62.

<sup>4</sup> See in general definitions of ‘coin’ in J Burke, *Jowitt’s Dictionary of English Law*, 2nd edn (London: Sweet & Maxwell, 1977) vol 1 at 368–69.

<sup>5</sup> See below section 3 of this chapter.

<sup>6</sup> And yet this was not always the case. For coin debasement, see below section 3 of this chapter.

<sup>7</sup> Rebuffat, above n 3 at 131.

<sup>8</sup> I Carradice, *Greek Coins* (London: British Museum, 1995) at 25. See also MacDonald, above n 3 at 62.

<sup>9</sup> Carradice, *ibid* at 32.

<sup>10</sup> MacDonald, above n 3 at 133.

the various pieces to tell its own tale', though occasionally, 'the type was modified in such a way as to indicate the denomination.'<sup>11</sup> Other than possibly for a short period at the beginning of coinage, coins were issued under the authority of the sovereign<sup>12</sup> who guaranteed the value, that is, the purchase power, of each coin by reference to its implicit or explicit denomination.

Coins were minted at mints to which individuals brought precious metal for minting.<sup>13</sup> Each mint operated as a business; in Antiquity it was originally of small size, and later of a larger scope.<sup>14</sup> By the late Middle Ages, the typical mint had become an extensive industrial enterprise.<sup>15</sup>

In 'its most primitive form', 'the minting of money was simply the placing of a seal on a lump of metal that has been tested for fineness and adjusted to a fixed weight'.<sup>16</sup> Originally, that is, as of around 700 BCE, 'coins were often irregularly shaped' and yet, even then, 'their weights were precise'.<sup>17</sup> Until around 1500 CE, coins were struck (that is, hammered) from melted and refined sheets of metal cut into blanks.<sup>18</sup> The screw press and the cylinder press, being the first generation of coining machines, were introduced approximately at the end of the Middle Ages, around 1500 CE; they lasted until about 1800 CE.<sup>19</sup>

A brief review of some economic fundamentals will clarify both the tenets of the system and the inherent deficiencies that, among other factors, led to its demise more than a thousand years after the end of Antiquity.

The value of each coin primarily derived from the amount of precious metal it contained. And yet, in principle, the value of the coin was higher, as it further reflected the coin production costs. Stated otherwise: as is the case for any manufactured product, the value of a coin had to be higher than that of the

<sup>11</sup> *Ibid* at 132.

<sup>12</sup> Herein lies the reason for the fluctuations in the number of issues in each time throughout Antiquity, depending on the 'phase of the struggle between [the] two conflicting political ideals' of numerous small city-states and one empire. MacDonald, *ibid* at 11.

<sup>13</sup> However, 'the citizen would not typically expect to receive the coins struck with his own metal. He would usually be paid with already minted coins': J Chown, *A History of Money From AD 800* (London and New York: Routledge, 1994, reprint 1996, transferred to digital printing 2005) at 10.

<sup>14</sup> See Rebuffat, above n 3 at 63–65.

<sup>15</sup> See in general essays in NJ Mayhew and P Spufford (eds), *Later Medieval Mints: Organisation, Administration, and Techniques – The English Oxford Symposium on Coinage and Monetary History* (Oxford: BAR International Series 389, 1988). In the Middle Ages, '[m]ost mints were contracted out to private entrepreneurs who were usually allowed different charges for different denominations.' TJ Sargent and F Velde, *The Big Problem of Small Change* (Princeton and Oxford: Princeton University Press, 2002) at 48. See also J Craig, *The Mint: A History of the London Mint From AD 287 to 1948* (Cambridge: University Press, 1953) at 1–95, and CE Challis, *A New History of the Royal Mint* (Cambridge: University Press, 1992) at 1–178.

<sup>16</sup> MacDonald, above n 3 at 75.

<sup>17</sup> Carradice, above n 8 at 11.

<sup>18</sup> See: Carradice, *ibid*; Sargent and Velde, above n 15 at 48–50; DR Cooper, *Coins and Minting* (Princes Risborough, UK: Shire Publications, 1983, reprint 1990) at 4–10; DR Cooper, *Coinmaking: A History of Minting Technology* (London: Spink & Son, 1988) at 7–18. See also Rebuffat, above n 3, at 63–68; and C Vermeule, 'Minting Greek and Roman Coins' 10:2 *Archeology* 100 (Summer 1957).

<sup>19</sup> See: Sargent and Velde, *ibid* at 53–61; Cooper, *Coins and Minting*, *ibid* at 10–20; Cooper, *Coinmaking*, *ibid* at 19–38. See also M Rachline, *La Monnaie de Paris* (Paris: Albin Michel, 1992) at 31–38.



metal it contained. Price fluctuations resulting in the value of a piece of metal exceeding the value of the coin made of it (plus melting costs) would bring about the demise of that coin.

Thus, where the value of the metal in a coin exceeded the fixed price in which the coin was denominated, the coin would be melted.<sup>20</sup> Conversely, bullion would be brought to the mint for minting only where the value of the resulting product, namely the coin, would cover both the value of the metal and the production costs. In the broad sense, those production costs consisted not only of the minting cost, called the 'brassage', but also of a tax paid to the sovereign, called 'seigniorage' or 'net seigniorage'.<sup>21</sup> Together, these costs formed the 'gross seigniorage', reflecting the liquidity service<sup>22</sup> rendered by the coin, not provided by the bare piece of metal of which it consisted.<sup>23</sup> The value of this liquidity service was the equivalent of the use-value of the coin as a means of payment discharging monetary debts. This liquidity service was reflected in the free circulation of a coin by mere tally, without the need to verify its weight and metallic content.<sup>24</sup> As will be examined in sections 2 and 3 below, opinion varied as to the significance of that component in the value of a coin. In effect, the conflicting views on this point underlie the distinction between metallism and nominalism, at least at its inception.

In any event, the quantity and the denomination mix of coined money in circulation were thus determined by the market. However, differentiation among coins complicated the operation of that market. Production costs were roughly equal for each coin regardless of its value. Accordingly, per unit of value, production costs were higher for small-value coins than for large-value ones. The incentives for individuals would thus have been to have metal minted to large-value coins; "Honest" petty coinage was unprofitable'.<sup>25</sup> To avoid shortage in small denominations, this impediment was occasionally remedied either by cross-subsidization of lower denomination coins by those of higher denominations, or the subsidization of the mint by the Government.<sup>26</sup> And yet, for a given amount of value, small-value coins were more numerous than large-value ones and thus took more space, and required higher storage and transportation costs.

<sup>20</sup> See eg Adam Smith, *The Wealth of Nations* Books I-III, with Introduction by A. Skinner (London: Penguin, 1970; reprint 1986; first published 1776) at 148 (Book I Chapter V).

<sup>21</sup> For these terms see eg JB Martin, 'Seigneurage and Mint Charges' (1884), 5 *The Institute of Bankers* 171 at 174. For a discussion on profits in one context, see eg P Spufford, *Monetary Problems and Policies in the Burgundian Netherlands 1443-1496* (Leiden: EJ Brill, 1970) at 130-46. For seigniorage and other mint costs see also FC Lane and RC Mueller, *Money and Banking in Medieval and Renaissance Venice: Coins and Money of Account* (Baltimore, Md: John Hopkins University Press, 1985) vol 1 at 16-23 and 493-530.

<sup>22</sup> Liquidity refers to 'the relative ease and small transaction costs associated with using an asset to make payment' so that an asset is said to be perfectly liquid when it 'is . . . the generally medium of exchange'. H Binhammer and PS Sephton, *Money Banking, and the Canadian Financial System*, 8th edn (Nelson: Thomson Learning, 2001) at 15.

<sup>23</sup> See eg Sargent and Velde, above n 15 at 50-53.

<sup>24</sup> *Ibid* at 9.

<sup>25</sup> Chown, above n 13 at 20.

<sup>26</sup> Sargent and Velde, above n 15 at 50-53.

As well, an increase in the price level for inexpensive items depreciated small-value coins, with which such items were to be purchased. The resulting higher rate of return for high-value coins led to a shortage that was met by debasement, that is, reduction in the metallic contents of small-value coins below their denominated value.<sup>27</sup> In turn, this encouraged individuals to have an abundance of metal minted into small-value coins, so as to profit from the difference between denominated value and the value of the metal, in excess of the 'gross seigniorage'. The resulting abundance of debased coins served only to trigger inflation, namely, to raise prices in the economy. In turn, this led to another reduction in the rate of return for small-value coin holders, and hence, ultimately, to further debasement, under the same cyclical process.<sup>28</sup> In the process, 'bad money drove out good'; individuals tended to keep those coins whose weight approximated their denominated value, and use in payment those of the same denomination with less valuable metallic contents.<sup>29</sup>

A further difficulty was that workers were paid in small-value, debased coins; whereas merchants sought to be paid with large-value coins. This resulted in further reduction in the value of small-value coins compared to those of large value, so as to decrease real wages and exacerbate inflation.<sup>30</sup>

This process in relation to small-value coins mostly took place in the Middle Ages. Later on, it led to the cessation of production of small-value coins in precious metal. Instead, small-value coins would be produced from inexpensive material and their value would be set at a fixed rate by reference to the value of large-value coins,<sup>31</sup> so that in the final analysis there would be no advantage to be gained by melting small-value coins. In fact, in the aftermath of the Middle Ages, the melting of small-value coins was one factor in the collapse of metallic money as a principal form of currency.<sup>32</sup>

The value of coins as money, that is to say, the purchase power embodied therein, 'can never, for any long period, fall below their value as a commodity, because they can always be converted from coin into metal by melting.' At the same time, 'the coin may rise above its metallic value.' Coins circulating above their bullion value are token coins.<sup>33</sup> 'The predominant reason for the issue of token money was the need for a small change money'.<sup>34</sup>

<sup>27</sup> As a rule, debasement could be carried out by a reduction in either weight or fineness; later in the Middle Ages it could also be achieved by decree. See Chown, above n 13 at 11.

<sup>28</sup> This indeed is the thesis of Sargent and Velde, above n 15 in the model and the theory they develop at 7–36 and further elaborate throughout their book. Unfortunately it is impossible to follow the precise reasoning without the benefit of a deep understanding of econometrics and related subjects (which I confess to lack).

<sup>29</sup> This is known as Gresham's Law, after Sir Thomas Gresham (1519–1571) who was the financial adviser of Queen Elizabeth I of England. See Chown, above n 13 at 16–17.

<sup>30</sup> Chown, *ibid* at 11–12, 20–22.

<sup>31</sup> In such a system the Government acts as a monopolist for small coins. Sargent and Velde, above n 15 at 373.

<sup>32</sup> Sargent and Velde, *ibid* at 306–19.

<sup>33</sup> AR Burns, *Money and Monetary Policy in Early Times* (New York: AM Kelley, 1965, reprint 1927) at 284. For token coinage see Burns, *ibid* at 284–313.

<sup>34</sup> *Ibid* at 311.

## 1.2 Origins

Nowadays, nearly all coins in circulation are tokens,<sup>35</sup> though in a context of a reformed currency system that defies metallism.<sup>36</sup> Thus, in the course of the nineteenth century, the coin reflecting a fraction of the unit of account became a token, that is, a piece of metal of a lower value than that which it denotes. The incentive for minting specie into an abundance of token coins was avoided by the division of the basic unit of account of the currency (for example, the dollar) into fixed token denominations at equal abstract sub-units.<sup>37</sup> This division is part of what the economists describe as ‘the standard formula for maintaining a sound system of fractional money’.<sup>38</sup> Under that formula, each coin representing fractional money is convertible at a fixed exchange rate to any other coin and to the basic unit (as well as to any other monetary object denominated in the basic unit or any fraction thereof such as a banknote). This is so regardless of the metallic (or otherwise intrinsic) composition of each coin or any other monetary object.<sup>39</sup> Thus, for example, the metallic content of a dollar is permanently convertible to four quarters; and four quarters are permanently convertible to one dollar. Also, typically, the basic unit of currency is neither issued as a current coin nor is it valued by reference to the amount of metal it represents.

However, in Antiquity, money evolved from a commodity traded for its use-value into currency transferred in payment of debts.<sup>40</sup> The ensuing discussion describes this evolution from chattels exchanged in barter systems to specific chattels having utility and use-value while serving as primitive money, up to the ultimate stage of the full-bodied metallic money,<sup>41</sup> in the form in which it survived into the Middle Ages.

<sup>35</sup> See Cooper, *Coins and Minting* above n 18 at 3.

<sup>36</sup> For metallism and nominalism, see section 2.1. For the modern currency system, see above ch 1, section 2.

<sup>37</sup> Eg one dollar for 100 pennies (each of one cent), 20 nickels (each of five cents), 10 dimes (each of 10 cents), or four quarters (each of 25 cents).

<sup>38</sup> CM Cipolla, *Money, Prices, and Civilization in the Mediterranean World, Fifth to Seventeenth Century* (New York: Gordian Press, 1967, originally published by Princeton University Press in 1956) at 27, on whom Sargent and Velde, above n 15 at 5 (as well as Preface at xvii) specifically draw.

<sup>39</sup> Ie 100 pennies, 20 nickels, 10 dimes, or four quarters, are convertible to one dollar. Two nickels are converted to a dime, etc. Each such conversion is irrespective of the metallic content of the sub-unit denominations (ie, the penny, nickel, dime, or quarter). In the language of Cipolla, *ibid*, compliance with the ‘standard formula’ requires ‘to issue on government account small coins having a commodity value lower than their monetary value; to limit the quantity of these small coins in circulation; to provide convertibility with unit money’ but not necessarily to limit the use of fractional money to payment reaching a specified amount. The ‘standard formula’ preceded the cessation of convertibility (discussed above in ch 1, section 2, text at n 48); yet, as it is understood today, the ‘standard formula’ does not rule out (nor does it require) that the basic unit, eg the dollar, be convertible or at least anchored to the value of a specified quantity of a given precious metal.

<sup>40</sup> For a comprehensive account see eg P Gardner, *A History of Ancient Coinage 700–300 BC* (Chicago: Ares Publishers, 1974, being unchanged reprint of the edition: Oxford, 1918).

<sup>41</sup> Certainly, however, the evolutionary process has not been uninterrupted. Thus, the process described below reflects the general direction in history. It does not take into account temporary deviations and setbacks. Eg, during the third and fourth centuries BCE, substantially after the rise of the coin, there was ‘a marked return towards primitive money’ throughout the Roman Empire.

Natural economy, in its pristine state, serves as a convenient starting point for the theoretical model that explains the evolution of metallic money. Natural economy is characterized by self-sufficiency; each economic unit produces for consumption alone and no exchange is conducted.<sup>42</sup> The simplest form of exchange economy is the barter system, or the exchange of goods for goods.<sup>43</sup> As an exchange method, barter suffers from two serious drawbacks.<sup>44</sup> First, there is no *a priori* measure of value, or a common denominator for the evaluation of goods. To facilitate an improved barter system, value of objects must be reduced to a common denominator. This was done already in Ancient Egypt, where a unit weight of copper served as an account unit for measuring the value of goods so as to facilitate their exchange.<sup>45</sup>

The second drawback is that in a barter transaction the buyer must also be a seller. The smooth operation of a barter system requires that the buyer commands resources sought by the particular seller. Stated otherwise, 'direct exchange can take place only when *double coincidence* of wants exists' (emphasis in the original).<sup>46</sup> Thus, it is not enough for a buyer to find a seller; the buyer must possess, or purchase in advance, goods that the seller wishes to buy in return for the object offered for sale. This requires an abundance of superfluous transactions. Also, in anything less than a perfect informational system, this means that a barter system often fails to maximize the satisfaction of its participants. For example, a would-be seller may not sell a chattel sought by a would-be buyer when the latter fails to procure the specific goods sought by the former.

'Primitive money' met the second drawback, though it grew out of the solution to the first drawback.<sup>47</sup> If a chattel could be used as an account unit, or as a

See P Einzig, *Primitive Money*, 2nd edn (Oxford: Pergamon Press, 1966) at 229. As well, side by side with payment in money as discussed in this chapter, section 2 below, the Talmud records payment in kind, usually in grain. See eg Talmud, *Bava Metzia*, at 105A (Rabbi Yehuda according to the Mishna). Limits on a debtor's right to discharge a debt by paying in kind are addressed in the Talmud, *ibid* at 118A (in conjunction with Rashi, 2nd D'H Ein). For primitive money in the medieval period see Einzig, *ibid* at 250–77. 'Primitive money' is defined below in text and nn 48–49.

<sup>42</sup> Historically, it is doubtful whether such an economy, in its pristine state, ever existed. See eg MM Postan, 'The Rise of a Money Economy' (1944), 14 *Economic History Review* 123 at 127.

<sup>43</sup> 'Goods', 'chattels', and occasionally 'objects' or 'commodities' are used herein interchangeably.

<sup>44</sup> To which Jevons adds a third one, acknowledged by him to be possibly only 'a minor inconvenience of barter', viz want of means of subdivision, that is, lack of small change. WS Jevons, *Money and the Mechanism of Exchange* (London, Henry S King & Co, 1875) at 6. Ironically, as indicated above (text and nn 27–32), issues relating to small change ended up significantly contributing to the demise of the coin monetary system.

<sup>45</sup> Einzig, above n 41 at 194–95. Accordingly, an ox, valued at 120 deben of copper, could be sold in Pharaonic Egypt for two pots of fat valued at 60 deben, five good shirts valued at 25 deben, one dress valued at 20 deben, and one hide valued at 15 deben. For this example, see P Grierson, *The Origins of Money* (London: Athlone Press, 1977, being the Creighton Lecture in History, 1970) at 17, fn 33.

<sup>46</sup> H Binhammer and PS Sephton, above n 22 at 14. Sargent and Velde above n 15 at 93 trace the idea to a statement in the Digest of the third century CE Roman jurist Paulus. This is in the passage cited below in n 316 and discussed in accompanying text.

<sup>47</sup> See text at n 45 above.

common denominator for which the value of all objects might be measured, the chattel itself might also be given in payment of goods. Thus, a buyer did not need to inquire as to what the seller wanted to buy; after being paid by chattels serving as a universal medium of exchange, the seller would be able to use the purchasing power expressed therein to buy what the seller wished, from whatever available source. Primitive money was 'a unit or an object conforming to a reasonable degree to some standard of uniformity, which is employed for reckoning or for making a large proportion of the payments customary in the community concerned, and which is accepted in payment largely with the intention of employing it for making payments.'<sup>48</sup> Primitive money was in fact a chattel with intrinsic utility and economic value, which in a given society served as a unit of account as well as a medium of exchange.<sup>49</sup>

In the prehistoric era, useful objects like weapons and rings, side by side with metals, were used as money.<sup>50</sup> Subsequently, in the pre-classical world, numerous objects served as primitive money. In Ancient Egypt, where economic exchange was predominantly done on a barter basis, various types of sticks or staves, copper objects, and gold served as a limited medium of exchange.<sup>51</sup> Barley and precious metals, particularly silver, were used as money in Babylonia and Assyria.<sup>52</sup> Sealed silver and copper ingots served this function in Cappadocia.<sup>53</sup> Sheep and weighed silver were the currency of the Hittite Empire.<sup>54</sup> The ancient Hebrews paid by livestock as well as by weighed silver.<sup>55</sup> A classic example is from the Biblical Book of Genesis Chapter 23; thereunder, in payment for the Cave of Machpelah,<sup>56</sup> the Patriarch 'Abraham weighted to Ephron . . . four hundred shekels<sup>57</sup> of silver, current money<sup>58</sup> with the merchant.'<sup>59</sup> Weighed metals served as money in domestic trade in Phoenicia.<sup>60</sup> Concurrently with metals, oxen and

<sup>48</sup> Einzig, above n 41 at 317.

<sup>49</sup> For the existence of this stage of the evolution of money, see also AJ Toynbee, *A Study of History*, abridgement by DC Somervell (London: Oxford University Press, 1960) at 60.

<sup>50</sup> Einzig, above n 41 at 187–92.

<sup>51</sup> *Ibid* at 193–202.

<sup>52</sup> *Ibid* at 202–09.

<sup>53</sup> *Ibid* at 209–10. See also Burns, above n 33 at 38.

<sup>54</sup> Einzig, above n 41 at 210–11.

<sup>55</sup> *Ibid* at 211–14. For a partial compilation of biblical authorities, see L Kadman and A Kindler, *Coins in Palestine Throughout the Ages* (Tel Aviv: Dvir Co and La Da'ath Publishers, 1963) [in Hebrew] 17. See also Y Grintz, 'Banking Services as Mentioned in the Bible' (1981), 20:80 *Quarterly Banking Review* 83 [in Hebrew].

<sup>56</sup> For a legal analysis of the transaction, see R Westbrook, 'Purchase of the Cave of Machpelah' (1971), 6 *Israel Law Review* 29.

<sup>57</sup> 'Shekel' is a weight unit. In Semitic languages, the word is of the same root as 'weigh'. The New Shekel is nowadays the official currency of the modern State of Israel. On the origin of the shekel, see Burns, above n 33 at 174–75.

<sup>58</sup> In Semitic languages, the same word denotes 'money' and 'silver'. The linguistic confusion is noted by Einzig, above n 41 at 212, fn 5, who uses a translation in the text, omitting the word 'money' altogether.

<sup>59</sup> Bible, Genesis 23:16. *The Holy Scriptures: According to the Masoretic Text* (Philadelphia: The Jewish Publication Society of America, 1955).

<sup>60</sup> Einzig, above n 41 at 215–16. As for foreign trade, see text and nn 71–72 below.

sheep were used as currency in Ancient Persia.<sup>61</sup> The Greeks<sup>62</sup> and Romans<sup>63</sup> used oxen and base metals as currency; *pecunia*, the Latin word for money, comes from *pecus*, or cattle.<sup>64</sup>

In an economy characterized by an increasing amount of payments, whether in trade, to labourers, or to mercenaries,<sup>65</sup> primitive money proved cumbersome. Cattle were not easily moved. Like any farm product, it was particularly unfit for transactions in towns.<sup>66</sup> On the other hand, precious metals could not pass freely from hand to hand without being first weighed and their quality tested. Perhaps these inconveniences explain why, throughout the pre-classical era, international trade, whether between kings or in sea-borne traffic,<sup>67</sup> was conducted on a barter basis.<sup>68</sup> Kings and large merchants commanded vast resources and could come up with goods sought by their trading partners; it was unnecessary for them to resort to a medium of exchange as an intermediary in their exchanges.<sup>69</sup>

Accordingly, the Biblical Book of First Kings informs us in chapter five that in connection with the purchase of building materials for the construction of the First Temple in Jerusalem by Solomon, King of Israel, 'Hiram [King of Tyre] gave Solomon timber of cedar and timber of cypress . . . And Solomon gave Hiram twenty thousand measures of wheat for food to his household, and twenty measures of beaten oil . . . year by year.'<sup>70</sup> Likewise, it is well established that the Phoenicians, 'who were probably the most enterprising commercial race for all times,'<sup>71</sup> did not use money in their extensive sea-borne trade operations. Rather, they bartered goods according to their value in terms of weighed metals.<sup>72</sup>

Nonetheless, barter did not dominate the long distance caravan trade.<sup>73</sup> Perhaps the network of commercial relations was much more complex compared to that existing in sea-borne commerce. It may have been harder for those trading by means of land caravans to match supply with demand – to master the

<sup>61</sup> Einzig, *ibid* at 219.

<sup>62</sup> *Ibid* at 220–25.

<sup>63</sup> *Ibid* at 225–28.

<sup>64</sup> 'Money (*pecunia*) is so called from cattle (*pecus*), because all the wealth of our ancestors consisted in cattle . . . So chattels (cattle) means all tangible personalty.' See Jowitt's *Dictionary of English Law*, above n 4, vol 2 at 1339 under '*Pecunia dicitur a pecus omnes enim veterum divitiae in animalibus consistebant.*'

<sup>65</sup> First Carthaginian coins were issued during the invasion of Sicily in 410 BCE, for the payment to mercenaries 'more accustomed to the use of money than their employers'. See Burns, above n 33 at 48.

<sup>66</sup> In Mesopotamia, the Code of Hammurabi (2123–2081 BCE) provided that payments in the country be made in grain, while payments in town be made in silver. See Einzig, above n 41 at 204. But the debtor (though not the creditor) was permitted to switch to the other currency. *Ibid*.

<sup>67</sup> But not in the caravan trade. See below text and nn 73–75.

<sup>68</sup> See Einzig, above n 41 at 214–16.

<sup>69</sup> Compare to text that follows n 46 above.

<sup>70</sup> Bible, above n 59, 1 Kings 5:24–25.

<sup>71</sup> Einzig, above n 41 at 487.

<sup>72</sup> *Ibid* at 215.

<sup>73</sup> *Ibid* at 216 and Burns, above n 33 at 53.

exact mixture of goods that would satisfy their prospective sellers.<sup>74</sup> Also, the physical bulk of commodities was of greater concern in the caravan trade than in sea commerce.<sup>75</sup> Hence, the carriage of goods which were designed to entice sellers of other goods, rather than the carriage of goods as objects for resale as an end in itself, proved a greater problem in the land-borne trade.

In theory, the deficiencies of the primitive money system, particularly as used in the caravan trade, could have been solved by the development of payment mechanisms. However, payment between distant parties presupposed that the reputation of those liable to pay was well established. In the final analysis, banking was not sufficiently developed throughout the ancient era to provide a universal system of payment by instruments which carried a banker's undertaking to pay in specie, at least beyond the banker's immediate territory. As well, the limited deposit-taking activity in Antiquity generated only rudimentary payment facilities so that no extensive payment mechanisms in primitive money developed in Antiquity, even on a local scale.<sup>76</sup>

Thus, the deficiencies of primitive money did not result in the evolution of payment mechanisms as a means to avoid the transportation of money. Nor did the cure for these deficiencies come by way of replacing or phasing out primitive money, or withdrawal to a barter system. Rather, the solution lay in the improvement of primitive money and its adaptation to the needs of commerce.<sup>77</sup> Weighed precious metals were to supersede cattle. In that process, metallic pieces were to be made of standard size and quality. Compared to oxen, metals 'are durable and can be stored without any cost of maintenance.' Particularly, precious metals were easy to hide. 'Gold and silver, though not copper and iron [or lead], are also easily portable.' Thus, '[t]he custom of making them into rings and spirals doubtless arose because people desired to carry their most precious possessions with them and therefore, placed them on their arms and legs.' Last, there 'was the homogeneity and divisibility of the metals' and the ability to make pieces of metal of any size that was desired.<sup>78</sup> Indeed, among all chattels, small fungible goods were the most suitable to be used as a medium of exchange. Fungible goods were mutually interchangeable; they could be replaced by equal quantities and qualities, and were estimated by weight, number, or measure.<sup>79</sup> Their individual identity, if it existed, was irrelevant. Small fungible goods, unlike oxen or sheep, were easily portable and could easily be hidden.

According to Jevons, an ideal 'monetary object' possesses five physical properties, viz, portability, indestructibility, homogeneity, divisibility, and

<sup>74</sup> Compare to text containing n 46 and as well as that containing nn 61–65 above.

<sup>75</sup> See references, above n 73.

<sup>76</sup> Payment instruments and funds transfers in Antiquity are discussed below in ch 3.

<sup>77</sup> A point highlighted eg by K Menger, 'On the Origin of Money' (1892), 6 *Economic Journal* 239 at 248–49 (trans by CA Foley).

<sup>78</sup> Burns, above n 33 at 28.

<sup>79</sup> See in general, FH Lawson and B Rudden, *The Law of Property*, 3rd edn (Oxford: Oxford University Press, 2002) at 27.



congnizability.<sup>80</sup> Standardized metallic pieces were to meet all such requirements; compared to other small fungible chattels like corn, barley or wheat, standardized metallic pieces are more durable and not depreciable. Specifically, gold neither tarnishes nor corrodes. The supply of precious metals was neither abundant nor scarce, and hence each piece could represent meaningful purchasing power while retaining a small size. It was true that, unlike grain or cattle, metallic pieces vary in size and quality; '[n]ature supplies no natural unit of the metals as she does of cattle.'<sup>81</sup> However, metallic units might be carved out and made into standard size and quality, each representing a fixed value. Thus, by a process of elimination, precious metals, shaped into standard pieces, were destined to prevail as a universal medium of exchange.<sup>82</sup>

The evolution of coined money out of primitive metallic money came in a gradual process of refinement. To begin with, inasmuch as precious metals had to be weighed and their quality attested to, they could not pass freely from hand to hand in the discharge of debts. In that respect, standardization, or the production of standard size and quality metallic pieces, was an improvement. Nonetheless, mere standardization did not provide the ultimate solution; this is so since a payee needed to be satisfied that the metallic piece tendered complied with the accepted standard. Some kind of assurance as to the quality of metallic money was thus required. Such assurance was forthcoming with the introduction of coins.

Coining was designed to facilitate the free transferability of metallic money by providing a guarantee of the fineness and weight of pieces of metal used as money so as to facilitate the exchange in trade. Indeed, viewing barter as 'not contrary to nature' in re-establishing 'nature's own equilibrium of self-sufficiency', Aristotle explained the origins of metallic money, as a source of 'money-making' or enrichment, as follows:

[A]s soon as the import of necessities and the export of surplus goods began to extend beyond national frontiers, the provision and use of a conventional medium of exchange inevitably followed. Not all the things that we naturally need are easily carried; and so for exchange purposes men entered into an agreement to give each other and accept from each other some commodity itself useful for the business of living and also easily handled such as iron, silver, and the like. The amounts were at first determined by size and weight, but eventually the pieces of metal were stamped. This did away with the necessity of weighing and measuring, since the stamp was put as an indication of the amount.<sup>83</sup>

<sup>80</sup> To those five traits, he adds two non-physical properties, viz (i) utility and value, and (ii) stability of value. See Jevons, above n 44 at 31.

<sup>81</sup> Burns, above n 33 at 28.

<sup>82</sup> From the biblical account of the famine in Egypt, at Genesis 47:13–20, we gain insight into the hierarchy of payment devices. In this instance, Egyptian peasants paid for food first by silver, then by cattle, and only finally by land. Unfortunately, the interchangeability between 'silver' and 'money' in Semitic languages is reflected in the English translation of this passage as well.

<sup>83</sup> Aristotle, *The Politics*, trans TA Sinclair (Harmondsworth: Penguin Books Ltd, 1962) at 42. For his negative view on the cause and effect of this development, see *ibid* at 38–46.



Tentative experiments in the sealing of metal ingots may have taken place in India, Assyria and Cappadocia, and Crete.<sup>84</sup> Cappadocia may have been the first country where ingots stamped by State authority were used as money. Silver ingots bearing official seals were already used there in regular commercial transactions between 2250 and 2150 BCE. The experiment was, however, abandoned.<sup>85</sup> There is also historical debate on the possible origins of money in the Ancient Near East, particularly in Mesopotamia; specifically, there is a disagreement on whether in eighth century BCE distinct items of value were actually used exclusively as means of payment, and thus approximated coins.<sup>86</sup>

The effective source of coining in Europe and Asia was in the Aegean basin in the Greek or 'half-hellenized'<sup>87</sup> city-state of Lydia in Asia Minor.<sup>88</sup> Coinage developed in Lydia around the seventh century BCE. According to one theory, the roots of Lydian money were in prehistoric discs and roundels found by Schliemann in Mycenae:

These objects . . . do not appear to have served any practical non-monetary purpose, and approach therefore the idea of modern<sup>89</sup> money. All that was needed to achieve this end was the seal of some authority to guarantee the weight and fineness of these primitive coins. Indeed, it is conceivable that the uniform design of these discs and roundels implied such a guarantee. This guarantee was actually expressed by means of a punch mark in the 7th century BCE in Lydia.<sup>90</sup>

Indeed, there are theories under which coinage did not originate in Lydia but, rather, had been imported from elsewhere; the overwhelming consensus is, however, that Lydia was at least the springboard for the subsequent spread and universal expansion of coinage.<sup>91</sup> Insofar as Lydian coinage was the first to gain a substantial degree of acceptability in its own territory so as to be an exemplar

<sup>84</sup> Burns, above n 33 at 51.

<sup>85</sup> Einzig, above n 41 at 209–10. See also Burns, *ibid* at 38.

<sup>86</sup> Proponents include M Balmuth, 'The Forerunners of Coinage in Phoenicia and Palestine' in A Kindler (ed), *The Patterns of Monetary Development in Phoenicia and Palestine in Antiquity* (Tel Aviv: Schocken, 1967) (Proceedings of the International Numismatic Commission, The Israeli Numismatic Society, International Numismatic Convention, Jerusalem 1963) at 25; M Balmuth, 'The Critical Moment: The Transition from Currency to Coinage in the Eastern Mediterranean' (1975), 6 *World Archeology* 293; and J Dayton, 'Money in the Near East Before Coinage' (1974), 23 *Berytus Archeological Studies* 41. For a critique see MA Powell, 'A Contribution to the History of Money in Mesopotamia prior to the Invention of Coinage' in B Hruska and G Komoroczy (eds), *Festschrift Lubor Matous* (Budapest, Eötvös Loránd Tudományegyetem, Ókori Történeti Tanszék 1978) vol 2 at 211. Another sceptic is P Grierson, above n 45 at 8, fn 7.

<sup>87</sup> According to Burns, '[t]he foundation laid by the Greeks or their half-hellenized neighbours, the Lydians, for the institution of coinage, was . . . one aspect of an intellectual development that embraced philosophy, art and commerce.' Above n 33 at 41.

<sup>88</sup> See eg Einzig, above n 41 at 217–19.

<sup>89</sup> Certainly, in this phrase, 'modern' is to be taken to mean 'coined'.

<sup>90</sup> Einzig, above n 41 at 192. However, it is possible that the alleged prehistorical origins are an overstatement. The Mycenae tablets do not give any clear indication of the medium of exchange by which contemporary business was transacted. Nor do they contain any evidence 'of anything approaching currency'. See M Ventris and J Chadwick, *Documents in Mycenaean Greek*, 2nd edn by J Chadwick (Cambridge: Cambridge University Press, 1973) at 113, 198.

<sup>91</sup> For the various views, see in general Burns, above n 33 at 39–43.

for others to follow, Lydia can truly be regarded as the effective source of coinage.

The circumstances under which the first coins were originally invented in Lydia remain controversial.<sup>92</sup> According to some historians, Lydia was a highly developed commercial community, a centre of land-borne international trade, situated on an important trade route.<sup>93</sup> To these historians, the invention of coin under such circumstances was obviously no surprise. But according to other historians, Lydia was a predominantly pastoral and non-commercial community.<sup>94</sup> Under this view, coins were introduced to Lydia by the Ionian Greeks who had settled in Asia Minor, and in any event, were used by the Lydians as a means to export metals of which they had an abundant supply.<sup>95</sup>

The earliest coins were struck in Lydia around 700 BCE.<sup>96</sup> They 'were of electrum, a natural alloy of gold and silver, and bore a design on one side only.'<sup>97</sup> Lydian electrum coins were 'crude bean-shaped ingots . . . All they bore was a primitive punchmark and there is a difference of opinion whether it guaranteed weight or fineness only, or both.' However, it is conceded that early Lydian coins were 'too large for convenient circulation and much too rudimentary to be accepted by tale.' Probably then, 'these primitive coins continued to change hands by weight,' and as such 'they may be considered to be on the borderline between primitive and modern money.'<sup>98</sup> This, side by side with their standard size reflecting one denomination, militates against the mercantile origin of those coins.

Indeed, existing evidence does not appear to support the mercantile origin of metallic money. Most coins were used within the area of issue, and their overwhelming local circulation does not indicate their alleged function as a medium of exchange in international trade. At the same time, the earliest coins were too valuable to have been of use in the petty commerce of daily life; and yet, there was no continuous supply of fractional denominations required to satisfy the needs of ongoing commerce.<sup>99</sup>

It is thus speculated that 'coinage was invented to make large number of uniform payments of considerable value in a portable and durable form, and that the person or authority making the payment was the king of Lydia.' Each such coin was for a single payment; possibly the purpose was payment to mercenaries.

<sup>92</sup> *Ibid.*

<sup>93</sup> For this view, see Burns, above n 33 at 42.

<sup>94</sup> For this view, see Einzig, above n 41 at 215, 218.

<sup>95</sup> Both an abundance of metal and richness of ruler are often mentioned as the reason for the emergence of Lydia as the source of Western coinage. See eg C Eagleton and J Williams, *Money: A History*, 2nd edn (London: British Museum Press, 2007) at 23.

<sup>96</sup> This is the conclusion, confirming the conventional wisdom on the matter, of the thorough study by D Kagan, 'The Dates of the Earliest Coins' (1982), 86:3 *Journal of Archeology* 343.

<sup>97</sup> Grierson, above n 45 at 7.

<sup>98</sup> Einzig, above n 41 at 218. As in the quote at n 89 above, 'modern' is to be taken to mean 'coined'.

<sup>99</sup> See Grierson, above n 45 at 10 and CM Kraay, *Archaic and Classical Greek Coins* (Berkley and Los Angeles: University California Press, 1976) at 317–28.

‘Some Lydian paymaster had the idea of preparing dumps of the correct weight instead of weighing out separately for each mercenary the same amount of electrum pellets or dust.’<sup>100</sup>

At the same time, the localized circulation of those coins militates not only against their origin in international trade but also against their use in payment to mercenaries. Also, the common authority for the diverse seals is challenged. Hence, it is argued, the early coins provided a means for standardized bonus payments, namely, a sort of severance pay, to employees.<sup>101</sup> Other speculations as to the use of Lydian coins are the facilitation of expenditure on public works and the payment of State salaries. By the same token, the State was to accept coins issued by it in payment of taxes and other payments made to the State.<sup>102</sup> Alternatively, coins could have been created for the fulfilment of religious obligations or dedications requiring standardized exact payments.<sup>103</sup>

### 1.3 Expansion

The origin of coinage in a small city-state such as Lydia is not surprising. Universal acceptance of a standardized medium of exchange must have originated in a small territory with an effective central government. As Arnold Toynbee wrote, ‘a state with a minimum area and population’ was a perfect laboratory for experimenting with the management of a coinage.<sup>104</sup> Nonetheless, he asserted, ‘it is equally evident that the utility of a coinage increases with the enlargement of the area in which it is legal tender.’<sup>105</sup> Such an expansionary step was taken in the early decades of the sixth century BCE, when Lydia ‘conquered all the Greek city-states along the western coast of Anatolia, except Miletus, as well as the interior as far as the River Halys.’<sup>106</sup> Nevertheless, the most decisive step in extending coinage occurred when Lydia fell and was incorporated into the Persian Empire. With the adoption of coinage by that Empire<sup>107</sup> ‘the future of coined money was assured.’<sup>108</sup>

Thus, the Lydian practice of placing punch marks upon the metallic unit medium spread quickly during the seventh century BCE to Asia Minor. Then it

<sup>100</sup> RM Cook, ‘Speculations on the Origin of Coinage’ (1958) 7 *Historia* 257 at 261.

<sup>101</sup> MJ Price, ‘Thoughts on the Beginning of Coinage’ in CNL Brooke, BHIH Stewart, JG Pollard and TR Volk (eds), *Studies in Numismatic Method*, presented to Philip Grierson (Cambridge: Cambridge University Press, 1983) at 1, 6–8. The author has doubts both as to whether mercenaries had settled in local communities and as to whether they ‘would happily have accepted overvalued lumps of electrum as payment’. *Ibid* at 6.

<sup>102</sup> Grierson, above n 45 at 10.

<sup>103</sup> Carradice, above n 8 at 23. For the ‘overwhelming importance of non-commercial payments in primitive life’ see eg Einzig, above n 41 at 314.

<sup>104</sup> AJ Toynbee, above n 49 at 619.

<sup>105</sup> *Ibid.*

<sup>106</sup> *Ibid.*

<sup>107</sup> Burns, above n 33 at 45.

<sup>108</sup> AJ Toynbee, above n 49 at 61.

spread, mostly throughout the sixth century BCE, to continental Greece and the neighbouring islands.<sup>109</sup> By the middle of the sixth century BCE, the practice 'was well established.'<sup>110</sup> Towards the close of that century, 'there was hardly a country in which the Greeks were established where coins were not in use.'<sup>111</sup> The Persians, having conquered Lydia in the middle of the sixth century BCE, adopted the idea of coinage from the conquered Lydians and facilitated its further expansion.<sup>112</sup>

Significant technological improvements in coin issuing took place in the Greek world towards the end of the sixth century, and particularly during the fifth and the fourth centuries BCE. A reverse design on the ingots was added and silver replaced electrum.<sup>113</sup> Also, the mark of the coin had finally developed into a mark of guarantee of weight as well as of fineness.<sup>114</sup> In fact, it had turned into a mark which vouched for the purchasing power embodied in each coin,<sup>115</sup> normally<sup>116</sup> as an approximation<sup>117</sup> of the expression of the value of its metallic content, namely, its commodity-value. The mark also came to serve another function. Covering most of the surface on both sides of a coin, the mark made it more difficult to cheat by clipping, that is, by cutting off the edge of the coin.

During that period, that is, towards the end of the sixth century and particularly during the fifth and the fourth centuries BCE, developments in mint organization occurred in Athens, allowing production of coins of uniform weight. All these developments together with improvements in the technical standard of the coin as well as the imposition of severe punishments for counterfeiting ensured that coins passed freely by tale.<sup>118</sup> Greek coins from that period thus constitute the oldest form of coined metallic money.

Roman coinage dates back to the third century BCE. At the time of the Twelve Tables, around 450 BCE, fines were still reckoned in terms of cattle and sheep. Nonetheless, by about 1000 BCE copper had appeared in Italy as a medium of exchange.<sup>119</sup> Coins were brought to Italy by Greek settlers. The

<sup>109</sup> See in general, Burns, above n 33 at 43–45. See also Rebuffat, above n 3 at 29–40, and Carradice, above n 8 at 19–30.

<sup>110</sup> Burns, above n 33 at 44.

<sup>111</sup> *Ibid* at 45.

<sup>112</sup> *Ibid*.

<sup>113</sup> *Ibid* at 44.

<sup>114</sup> Compare to text and above n 91.

<sup>115</sup> The practice of marking the nominal value of coins on the coins themselves was introduced by the Greek colonies in Italy and then adopted by Rome 'where there was a persistent policy of stating the value of coins upon their face.' Prior to that practice, in Greece, reliance must have been placed on the size of the coin to distinguish one denomination from another. Burns, above n 33 at 134–35. See also text containing nn 8–12 above.

<sup>116</sup> Exceptions such as small change and in connection with debasements are discussed in this chapter in section 1.1 above, as well as in section 1.4 and section 3 below.

<sup>117</sup> This qualification reflects brassage plus net seigniorage which provide the coin with more than the value of the bullion, so as to reflect liquidity. See above section 1.1, paragraph containing nn 20–24.

<sup>118</sup> See in general Burns, above n 33, at 58–61.

<sup>119</sup> See eg W Kunkel, *An Introduction to Roman Legal and Constitutional History*, trans by JM Kelly, 2nd edn (Oxford: Clarendon Press, 1973) at 8–9.

foundations of local coinage in Italy were laid by the practice of marking large square copper and bronze bars, weighing four and five pounds each, usually with figures of cattle. The practice made its way to Rome around 450 BCE, about the time of the Twelve Tables. Around the same time, clumsy round copper coins, weighing a pound each, were issued in Rome under State authority. These coins, known as *aes grave*, were regarded as the first Roman coins. They were soon to be replaced by more advanced silver coins.<sup>120</sup>

The first silver coinage was issued in Rome towards the middle of the third century BCE. It was modelled upon the earlier silver issues of Etruria and Campania. The model for these Italian silver issues was provided by the Greek cities of Southern Italy. Later, with the expansion of Roman trade and sphere of influence, Roman silver coins were introduced into Spain, Gaul, and Britain.<sup>121</sup>

In the process, commerce was quick to adopt the coin as a universal medium of exchange. For local retail, small-value payments, the turning point occurred during the second half of the fifth century BCE, when technology facilitated the introduction of bronze coinage.<sup>122</sup> The widespread adoption of base metal for coinage, facilitating the use of coins also in low-value retail transactions, took place during the fourth century BCE. It is in the course of this process that the use of coins came to remedy the deficiencies of the primitive money system.<sup>123</sup>

The adoption of coined money in international trade had been more complex. That was so since, in commerce between distant parties, the local stamp on metallic money might have been of a limited value. This was in line with the experience with the forerunners of the early bills of exchange discussed above in section 1.2. A payee unfamiliar with a particular seal would not accept metallic money at its stamped face value.<sup>124</sup> This explains the local circulation of ancient coins:

Coins will have been in greatest demand in the area controlled by the minting authority; beyond that they will have been in demand in places in regular contact with the area of origin; elsewhere they will have tended to revert to the value of bullion.<sup>125</sup>

Indeed, international trade, while giving rise to the need for coinage, did not set the stage for its emergence. Nor was international trade the predominant force behind the expansion of coinage. The original monetary system, under which each small political entity issued its own coinage, had built-in impediments to the universal expansion of coinage.

<sup>120</sup> See in general Burns, above n 33 at 48–49. For the continuing ceremonial use of the *aes grave*, see Einzig, above n 41 at 229.

<sup>121</sup> Burns, *ibid* at 50.

<sup>122</sup> Price, above n 101 at 5–6. For the impracticality of a small-value (and hence extremely small-size) silver coin, see eg MacDonald, above n 3 at 41.

<sup>123</sup> Burns, above n 33 at 50.

<sup>124</sup> This may explain why Phoenicia was quite late to adopt coinage. See eg Einzig, above n 41 at 216. ‘Not until the middle of the 5th century [BCE] did the great Phoenician cities of Tyre and Sidon make issues of coins.’ Burns, above n 33 at 46. For the position of Phoenicia as a leading bartering maritime trader, see text and above nn 71–72.

<sup>125</sup> Kraay, above n 99 at 323.

A limited expansion through international trade was staged by the rise of some local coins to international acceptability and by the establishment of monetary unions in the Greek world.<sup>126</sup> However, as was already indicated,<sup>127</sup> the major and irreversible territorial expansion occurred in the East, in Imperial Lydia, and in its successor, Persia. Philip of Macedon and his successor Alexander the Great who, throughout the fourth century BCE, united the Greek world and subsequently conquered the Persian Empire, had not modified the foundation of the coinage system.<sup>128</sup> It was left to Imperial Rome to consolidate coinage issue and provide for a uniform system of coinage universally accepted throughout the Roman Empire.<sup>129</sup> Thus, the control provided by imperial power over a vast territory was the primary driving force behind the free transferability, by tale, of metallic money. To that end, the contribution of imperial power was greater than that of the voluntary consensus of either the international business community or the separate political entities of the ancient world.

Indeed, coinage may have originally been issued privately<sup>130</sup> as an outgrowth of the use of weighed metal money. Even so, the State was soon to nationalize private coinage. There are two main reasons that account for that process. The first reason was the reliability and familiarity of the seal of a public servant.<sup>131</sup> Free transferability of standardized metallic pieces required complete faith in the assurances given by the seal as to the quality and quantity of the metallic unit.<sup>132</sup> In this respect, a public seal appeared most credible. Coinage became an expression of State prerogative relating to the standardization of weights and measures, exercised as a matter of social concern in the pursuit of enforcing honest dealing standards in the market place.<sup>133</sup> To that end, the alternative to State issue monopoly, that is, the establishment of public facilities for passing the metals by weight and the giving of a guaranty by a weigh-master, turned out to be less successful.<sup>134</sup> Unlike State coinage, such a system neither generated standard metallic pieces nor eliminated the need for at least one weighing in connection with the first payment in which a given piece was used.

<sup>126</sup> See in general, Burns, above n 33 at 85–95.

<sup>127</sup> Text and above nn 106–07.

<sup>128</sup> Burns, above n 33 at 95–96. Alexander the Great 'left the states under his suzerainty to manage their currency systems for themselves . . . Perhaps if he had lived a few years longer he would have set up a coinage for the whole of the ancient world, and enforced its circulation by the same methods as the Persians before and the Romans after him.' *Ibid* at 96.

<sup>129</sup> *Ibid* at 100–08. As was the case in previous empires, local bodies were usually left to supply coinage for small change (*ibid* at 109) but this was essentially a matter of devolution of power.

<sup>130</sup> For early private coining, see in general, Burns, above n 33 at 75–77. For traces of private coinage in Babylonia and Assyria, see Einzig, above n 41 at 203, 205, and 207.

<sup>131</sup> Burns, above n 33 at 108.

<sup>132</sup> Hence, the limitation of early coinage to the small, territorial unit of the issuance. See paragraph preceding the one containing n 126 above.

<sup>133</sup> AJ Toynbee, above n 49 at 612, 618. For a detailed historical account, see W Ridgeway, *The Origin of Metallic Currency and Weight Standards* (Detroit: Singing Tree Press, 1970, being a facsimile reprint of the 1892 edition).

<sup>134</sup> See eg Burns, above n 33 at 109.

The second reason for the early nationalization of private coinage was historical. Merchants and bankers,<sup>135</sup> who under one view made the first issues in Lydia,<sup>136</sup> were soon to assume ultimate political power in the city. When economic might was thus translated into direct political power, the tyrant 'kicked away the ladder by which he had risen lest others might attempt to use it.' Tyranny as well as coinage were said to have originated in Lydia.<sup>137</sup> Apart from serving the citizens, coinage also began to serve the interests of those ruling them.<sup>138</sup>

Indeed, the first reason given for the early nationalization of private coinage<sup>139</sup> could not support a complete theory. By itself, the absence of an internationally reputed banking network in the ancient world<sup>140</sup> did not explain the formation of a State monopoly on coin issuing. The 'territorial reach' of the reputation of a locally known banker need not be smaller than that of the local ruler.<sup>141</sup> In fact, there was no evidence whatsoever that in a given territory, the seal of an officer of the State was *universally* more reliable than that of a well-reputed ban<sup>142</sup> But where the banker had acquired the monopoly, he translated it into political power, and transferred the coinage authority to the State as a means of protecting his newly acquired power. Whether placed there by virtue of public confidence or political struggle for domination, coinage was laid solely in the State's hands. Inasmuch as imperial power preceded financial power in enforcing the acceptance of a universal medium of exchange in a vast territory,<sup>143</sup> State prerogative of coin issuing was reinforced.

Soon, inscriptions upon coins came to express political power and the position of coins, as State authority had thereby been bolstered. One expression of this trend was the change of attitude towards the placing of the ruler's portrait upon coins. Thus, in the Greek world and the Roman Republic, democratic opinion ran counter to the engraving of the portraits of living persons upon coins. The practice of placing the ruler's effigy on coins was introduced, or at least reinforced, by Imperial Persia. Thereafter, engraving the portraits of living

<sup>135</sup> Needless to say, 'bankers' is used here in a loose sense, denoting financiers in general.

<sup>136</sup> Burns, above n 33 at 76–77.

<sup>137</sup> *Ibid* at 82–83.

<sup>138</sup> AJ Toynbee, above n 49 at 620. For the view that universally, 'government's exclusive right to issue and regulate money' has not served the citizens but only those who rule them, see FA Hayek, *Denationalisation of Money—The Argument Refined*, 3rd edn (London: The Institute of Economic Affairs, 1990) at 32–33, where the author contends that this exclusive right 'has certainly not helped to give us a better money'. Rather, 'it has . . . become a chief instrument for prevailing governmental policies and profoundly assisted the general growth of governmental power' that 'was regularly used to exploit and defraud [people]'.

<sup>139</sup> See text, paragraph containing nn 130–34 above.

<sup>140</sup> Banking and banking operations in the Ancient World are discussed below in ch 3.

<sup>141</sup> For the difficulties raised by the limited territorial reach of the reputation of each seal, see text at n 124 above.

<sup>142</sup> See eg Burns, above n 33 at 78, 83. In fact, in Lydia and Persia, as of the beginning of the sixth century BCE, 'after state issues were instituted merchants and bankers continued to use their punches and marked the new coins, possibly because some of their clients, faithful to tradition, trusted only their banker's mark.' Persian shekels are often found with their surface almost covered with these small punch marks: Burns, *ibid* at 83.

<sup>143</sup> As explained in text at nn 127–29 above.



rulers became a valid expression of the divinity of the reigning monarch and his sovereign power.<sup>144</sup>

The process was carried even further in the Roman Empire:

From the middle of the first century onwards the Imperial Government had appreciated . . . not only the function of coinage as a mirror of contemporary life – of the political, social, spiritual, and artistic aspirations of the age – but also its immense and unique possibilities as a far reaching instrument of propaganda. *Modern methods of disseminating news and modern vehicles of propaganda* . . . have their Counterpart in the imperial coinage, where . . . novelties and variations in types record the sequence of public events and reflect the aims and ideologies of those who control the state [emphasis added].<sup>145</sup>

Circulation of coins carrying news about military victories, political achievements (even imaginary) and other information on the greatness of an incumbent ruler (whether true or false) had thus become a primary State interest.

Needless to say, this rationale for circulation had nothing to do with the function of coins as a medium of exchange. Nevertheless, by becoming an end in itself, the State stamp served to bolster the use of metallic money.

The legitimacy of assigning coinage to State prerogative was expressed in a classic New Testament passage. Jesus said, '[r]ender to Caesar the things that are Caesar's, and to God the things that are God's',<sup>146</sup> explicitly referring to a coin bearing the emperor's image and title. Such a coin was the example par excellence of 'the things that are Caesar's'.<sup>147</sup> Also, as Toynbee pointed out, the same Jews who vehemently opposed the displaying of the Roman Emperor's image in Jerusalem in 26 CE, 'had schooled themselves meekly, not only to seeing but to handling, using, earning, and, hoarding the abominable image on Caesar's coinage.'<sup>148</sup> Having the hated Emperor's image impressed on the current metallic money was thus acceptable.

Within each State, the location of the coinage power depended on the form of political organization.<sup>149</sup> In Lydia, Persia, and Macedon the power was in the King's hands.<sup>150</sup> In democratic Greek cities and the Roman Republic, control

<sup>144</sup> Burns, above n 33 at 113–35, specifically at 133–35. See also Carradice, above n 8 at 43, 58–60, 63–64.

<sup>145</sup> JMC Toynbee, *Roman Medallions* (New York: The American Numismatic Society, 1944) at 15, as quoted in Toynbee, above n 49 at 621–22. On Roman coins bearing inscriptions relating to their issue see MacDonald, above n 3 at 108–09.

<sup>146</sup> Mark 12:17. See also Matthew 22:21, and Luke 20:25. J Stirling (ed), *The Bible: Authorized Version* (London: The British & Foreign Bible Society, 14th impression, 1959).

<sup>147</sup> *Ibid.* Also see Toynbee, above n 49 at 621.

<sup>148</sup> AJ Toynbee, *ibid* at 621.

<sup>149</sup> Burns, above n 33 at 110.

<sup>150</sup> The power could however be delegated by the Imperial King to heads of vassal states, as we read in I Maccabees 15:6 on the authority given (in the 130s BCE) by the Seleucid King Antiochus VII to Simon, Ethnarch of Judea, to 'issue special currency legal tender in your land The Book of I Maccabees 5th edn (Tel Aviv: Yavneh, 1979, trans to Hebrew and commented on by AS Hartom) belongs to the *Apocrypha*, namely, books included in the Septuagint and Vulgate (published in stages between the 3rd and 2nd century BCE in Alexandria, Egypt) but excluded from the Jewish Holy Scriptures as well as from the Protestant canon of the Old Testament.



was in the people's hands. In Imperial Rome, the prerogative to issue gold and silver coinage was held by the Emperor.<sup>151</sup> Administratively, coinage was typically controlled by magistrates or commissioners.<sup>152</sup> The English word 'money' comes from the Latin *moneta*, after the temple of Juno Moneta on the Capitoline Hill where the mint at Rome was set up in 268 BCE or possibly earlier.<sup>153</sup>

In the Roman Empire, metallic money acquired, conclusively and irreversibly, the form of a standardized small size metallic chattel, issued by the State and stamped by its authority with certain marks and devices. Such marks and devices began to guarantee the quantity and quality of the materials embodied in the metallic piece, and ultimately its nominal purchasing power, normally as an expression of the value by reference to its metallic content. These marks also served as a medium for the political expression of sovereignty. Such metallic pieces were put into circulation to be used solely as a universal medium of exchange at the fixed value expressed on their face. The evolutionary process whereby a chattel was adopted to serve exclusively as a medium of exchange in an exchange economy was thus completed.

#### 1.4 Debasement and Transformation

Medieval monetary history in Europe is divided into two principal periods. The first ran from the seventh to the twelfth century CE and was characterized by the silver penny. The second period began in the thirteenth century and had a more complex currency system which included large silver and gold coins. Only limited coin payments were made in the first period.<sup>154</sup> Conversely, extensive use of money was made in the course of the second period.<sup>155</sup>

The fall of Rome in 476 CE marked the end of Roman institutions, including the coinage system.<sup>156</sup> Following a long period of transition, King Pepin the Short (father of Charlemagne), who reigned in France between 751–758 CE, introduced a new standard for silver coinage. Under that standard, a livre

<sup>151</sup> Burns, above n 33, at 108–10.

<sup>152</sup> They were frequently required to place their mark on all coins made under their surveillance. *Ibid* at 62. For state control and supervision over coinage see also MacDonald, above n 3 at 12–36, 123.

<sup>153</sup> Burns, *ibid* at 65.

<sup>154</sup> For payments in kind, assessed in monetary value and on occasion supplemented with low-value coins, that took place in the Carolingian Empire (eighth century CE), see eg A Murray, *Reason and Society in the Middle Ages* (Oxford: Clarendon Press, 1978, reprint 2002) at 31–35.

<sup>155</sup> P Spufford, *Money and its Use in Medieval Europe* (New York: Cambridge University Press, 1988) at 378 (hereafter: Spufford, *Money*). For a succinct review followed by a list of coins most commonly used in the Middle Ages and summary of their features, see P Spufford, 'Appendix: Coinage and Currency' in MM Postan, EE Rich and E Miller (eds), *The Cambridge Economic History of Europe*, vol III: Economic Organization and Policies in the Middle Ages (Cambridge: Cambridge University Press, 1965, reprint 1979) at 566, 597. See also Eagleton and Williams, above n 95 at 62–85.

<sup>156</sup> Eagleton and Williams, *ibid* at 62.

(pound) weight of silver was divided into 240 denarii (pennies).<sup>157</sup> King Pepin the Short thus became the 'effective founder of the Western European monetary system', that in principle survived in Britain until 1971.<sup>158</sup> The establishment of uniform coinage in the Carolingian Empire, which lasted until the commercial revolution of the thirteenth century CE, is however attributed to Charlemagne himself at 794 CE.<sup>159</sup>

For centuries in Europe, and subject to occasional exceptions, the penny was the only coin in circulation.<sup>160</sup> There was no coin for the pound, which thus was a mere unit of account, or 'ghost money'.<sup>161</sup>

Coined money was current in Britain long before the Roman conquest and had been known to the Angles, Saxons, and Jutes before they invaded the island.<sup>162</sup> Anglo-Saxon money was coined in Britain at least as early as the sixth century CE.<sup>163</sup> Around 760, Offa, King of the Saxon Kingdom of Mercia, coined the silver penny.<sup>164</sup> Having survived the 1066 Norman conquest,<sup>165</sup> the penny remained the basic unit of currency in England in the early Middle Ages.<sup>166</sup> In line with the monetary system established by King Pepin the Short in France, as described above in this subsection, the 'pound' consisted of 240 'pennies'. Early in the twelfth century, the penny acquired the name 'sterling'.<sup>167</sup>

<sup>157</sup> Minting of the silver penny, or denier, began at seventh century CE. Spufford, *Money*, above n 155 at 27.

<sup>158</sup> Chown, above n 13 at 23.

<sup>159</sup> Sargent and Velde, above n 15 at 45 and Spufford, *Money*, above n 155 at 101–02. For a historical review of the French currency system, from Pepin the Short and Charlemagne until the advent of the Euro, see eg J Demougin (ed), *Histoire du Franc* (Paris: Tresor, 2003). For a historical review of royal currency in France, see eg TJA Le Goff, 'Monetary Unification under the French Monarchy' in PM Crowley (ed), *Before and Beyond EMU* (London: Routledge, 2002) at 42.

<sup>160</sup> Eagleton and Williams above n 95 at 73. Except that '[a]s market transactions became more common there was a growing demand for smaller denominations. Round halfpennies were struck from the mid-ninth century, but only intermittently, and needs were otherwise met by cutting the penny into halves and quarters.' *Ibid.*

<sup>161</sup> 'No actual shilling coin was struck in England until 1508, in the reign of Henry VII, and the coin only entered general circulation under his grandson, Edward VI.' Chown, above n 13 at 23. As a unit of account, the shilling was the equivalent of the then current Byzantine gold solidus (or sou) which was worth 12 pennies or 1/20 pound. *Ibid.* For the pound as 'ghost money' see Chown, *ibid* at 17–22.

<sup>162</sup> See eg Postan, above n 42 at 125. For English coined money, see J Kent, *2000 Years of British Coins and Medals* (London: British Museum Publications, 1978, published for the Trustees of the British Museum). For 'primitive money' used in Great Britain and Europe in the Ancient Era and the Middle Ages, see Einzig, above n 41 at 231–72.

<sup>163</sup> Postan, *ibid* at 126.

<sup>164</sup> A Feavearyear, *The Pound Sterling – A History of English Money*, 2nd edn by EV Morgan (Oxford: Clarendon Press, 1963) at 7. For the first coins of the English, see Kent, above n 162 at 15, where the penny is traced to King Pepin.

<sup>165</sup> In general, the Norman conquest made little initial impact on the English coinage. Kent, *ibid* at 25.

<sup>166</sup> JL Bolton, *The Medieval English Economy 1150–1500* (London: JM Dent & Sons Ltd, 1980) at 73.

<sup>167</sup> See in general, Feavearyear, above n 164, at 7–8. The origins of the word 'sterling' are shrouded in uncertainty: 'In the *Case de Mixt Moneyes* [(1605) Davis 18, 80 ER 507, (KB)] the word "sterling" is said to be derived from the fact that the early Kings employed people from the East to make pure English money. These people were called "Esterling", and the coins they made were called sterling

In Continental Western Europe the penny survived as 'the only coin at any given location' until around 1200 CE.<sup>168</sup> Thereafter, with the total collapse of the Carolingian Empire, there was no centralized monetary authority in Western Europe. Coins were struck by various feudal lords and ecclesiastical authorities,<sup>169</sup> in multiple denominations, 'with the penny . . . as the lowest, or one of the lowest.'<sup>170</sup> Over the years, the penny gradually debased in its silver content; a coin with an increased copper in proportion to silver became known as 'black money' or 'billon', which became suited mainly for low-value transactions. For high-value payments, large silver coins were minted,<sup>171</sup> and gold coinage was re-introduced, primarily by Italian city-states.<sup>172</sup>

The Middle Ages introduced a modification in the philosophy concerning metallic money. In the Ancient Era, the function of the government seal impressed upon a coin and denominating it was to *certify* its intrinsic value. During the Middle Ages, the seal came to *confer* upon the coin its exchange value.<sup>173</sup> In fact, this transformation was inevitable. The value of the metallic content of a coin is not static and thus, like any other commodity, is shaped by market forces and is not immune from changes. Nonetheless, frequent readjustments of nominal to real values may not always be politically desirable. These precipitated complex policies designed to ensure the stability of nominal values or to keep nominal values in line with other policies of the respective issuer of coined money.<sup>174</sup> Ultimately, the purchasing power of any coin had to adjust to the value of its metallic content. If not by redenomination, this adjustment was to be accomplished by changes in the level of prices, so as to reflect the varying purchasing power pertaining to the coin.<sup>175</sup> However, during the transition, the nominal value of the coin did not mirror the real value of its metallic content.

Chronic shortage of small change, inherent in a coined money system under which the denomination of a coin purports to reflect the value of its material,<sup>176</sup>

money. This view is not . . . acceptable to antiquarians today. They think the word had its origin in the fact that some of the early coins had a small star on them.' *Treseder-Griffin v Co-operative Insurance Society Ltd* [1956] 2 QB 127 at 147 (CA) per Denning LJ.

<sup>168</sup> Sargent and Velde, above n 15 at 46.

<sup>169</sup> Chown, above n 13 at 24.

<sup>170</sup> Sargent and Velde, above n 15 at 46.

<sup>171</sup> *Ibid.*

<sup>172</sup> Eagleton and Williams, above n 95 at 79–80.

<sup>173</sup> For this transformation, see Hayek, above n 138 at 32–33.

<sup>174</sup> There is voluminous literature on the chronic shortages in precious metals during the Middle Ages, their impact on the monetary systems, and the ensuing policies adopted by various rulers. See eg AM Watson, 'Back to Gold – and Silver' (1967), 20 *Economic History Review* 1; J Day, 'The Great Bullion Famine of the Fifteenth Century' (1978), 79 *Past and Present* 3; JH Munro, 'Bullionism and the Bill of Exchange in England, 1272–1663: A Study in Monetary Management and Popular Prejudice' in Center for Medieval and Renaissance Studies, University of California, Los Angeles (ed), *The Dawn of Modern Banking* (New Haven: Yale University Press, 1979) at 169. Detailed lists of specific measures employed in England are appended to the latter essay.

<sup>175</sup> The inability to maintain by decree price stability was demonstrated at the end of Antiquity, with the failure of Diocletian's Price Edict of 301 CE, being a 'misguided attempt to stop inflation simply by making it illegal'. Eagleton and Williams, above n 95 at 59.

<sup>176</sup> See discussion in section 1.1 above.

only aggravated the process. In any event, debasement was a characteristic feature of the Medieval currency landscape.<sup>177</sup> Instances of discrepancy between nominal and real values brought about policies directly designed to create a disparity between the nominal and real values of coins to the advantage of the coin issuer.<sup>178</sup> This was reflected in the frequent debasements and re-coinages practised by princes and dukes of Medieval Europe as a way of raising revenues. In Medieval Europe, the prince had the right to take a percentage of all bullion brought to his mints for coining, including re-coinage, when the metal brought was in the form of old coins. In fact, this was the net seigniorage referred to earlier in section 1.1 of this chapter. However, the prince used his power to confer face-value on the coin above that of the metal and the liquidity service of the coin; in addition the net seigniorage charged by the prince became a source of income. Thus, bullion was attracted to mints by setting an attractive price for it. Stated otherwise, bullion was attracted to mints by ensuring that merchants, bringing bullion or old coins to be struck into new coins, received more back in face value than they brought in. Furthermore, merchants could get a debased coin of less expensive material, and yet above the value of what they brought in. Needless to say, prices tended to adjust to the value reflected in the metallic content of a coin, in spite of its face value. A reduction in fineness, or bullion content, would eventually lead, through rising prices, to a decline in the purchasing power of the same amount of money. In the short term, however, the merchant would reap a profit.<sup>179</sup>

During the latter part of the Middle Ages, England was the only European country which did not practice frequent re-coinages.<sup>180</sup> The result was that English coins were of good quality and had a high metal content.<sup>181</sup> Yet, the country underwent ‘the Great Debasement’ in the middle of the sixteenth century CE, during the reigns of Kings Henry VIII and Edward VIII.<sup>182</sup>

<sup>177</sup> There is a voluminous literature, some of which is not entirely accessible to the uninitiated in econometrics, on the causes for Medieval ongoing currency debasement. Other than Sargent and Velde, above n 15, see eg AJ Rolnick, FR Velde and WE Weber, ‘The Debasement Puzzle: An Essay on Medieval Monetary History’ (Fall 1997), 21:4 *Federal Reserve Bank of Minneapolis Quarterly Review* 8; S Quinn and W Roberds, ‘The Big Problem of Large Bills: The Bank of Amsterdam and the Origins of Central Banking’ 22 January 2007 [unpublished] (for a former version, see Federal Reserve Bank of Atlanta, Working Papers Series, Working paper 2005-16, August 2005); and CM Cipolla, ‘Currency Depreciation in Medieval Europe’ (1963), 15 *Economic History Review*, New Series, 413 (hereafter: Cipolla, ‘Currency’).

<sup>178</sup> It should be noted, as a matter of historical accuracy, that such policies go back to the Ancient Era as well. Eg, ‘it is reported that Solon [during the sixth century BCE in Athens] instituted special weights for use in the mint which were 5 per cent lighter than the market weights. The profit from this source could be increased from time to time by declaring certain issues “unacceptable”, thus compelling those who needed coins to have their holdings converted into “acceptable money” at a charge.’ Kraay, above n 99 at 322. However, the employment of such policies in the Ancient Era was not inherent in the monetary system as subsequently in the Middle Ages.

<sup>179</sup> See in general, Bolton, above n 166 at 297–98, 73–75.

<sup>180</sup> *Ibid.* See also Cipolla, ‘Currency’ above n 177 at 414, 419.

<sup>181</sup> *Ibid.* at 298. Unlike other European countries, the main vehicle for the acquisition of bullion was the wool trade. *Ibid.*

<sup>182</sup> Chown, above n 13 at 41–55.

Arguably, practices of debasements and re-coinages, premised upon the ruler's power to confer value upon money, set the stage for the introduction of paper money. Indeed, if it is not necessary for the face value of a coin to reflect its intrinsic value, why should it be required that the 'coin' be of any intrinsic value at all? However, this philosophical change, although it facilitated the acceptance of a disparity between the face value and the intrinsic value of money (on which paper money was to be premised), did not bring about the introduction of paper money. Historically, as set out below in chapter ten, paper money emerged in the form of banknotes, as a by-product of the evolution of payment mechanisms, that is, machineries that facilitated the transmission of monetary value while avoiding physical delivery of money.<sup>183</sup> However, as long as the transformation from metallism to nominalism had not been completed, banknotes, in the footsteps of debased coins, gave claims to metallic value.

In any event, the historical process was more complex. With the advent of the New Era after the end of the Middle Ages, namely, during the sixteenth and seventeenth centuries, shortage of precious metal had disappeared when Europe was flooded with silver and gold forcefully taken from the New World. However, rather than a stable coined currency, this over-supply led to a marked decline in the value of precious metal. This led to inflation, as more precious metal was required to purchase the same goods and services. Wasteful management, corruption and investment in destructive wars only exacerbated the situation.<sup>184</sup> At the same time, demand for investment in innovations, discovery expeditions and voyages only increased. At the new price level, available metal could not satisfy all needs; liquidity had to be provided by fractional reserves and banknotes.<sup>185</sup>

The banknote could thus serve as an obligation to pay metallic money, not necessarily available in the coffers of the issuer in the entire amount of the issue. Stated otherwise, obligations on banknotes could be incurred in an amount designed to meet an anticipated demand for the metallic coins. Moreover, the coins to be paid on an obligation were at their prescribed value, which was not necessarily their intrinsic value. Certainly, the emergence of paper-money systems is associated with nominalism; however, as set out in this subsection, it was the debasement of the coined money which allowed the breakaway from metallism.

<sup>183</sup> Besides cheques and banknotes, which arose later, such payment mechanisms included tallies, tokens and obligatory writings (see SJ Bailey, 'Assignments of Debts in England from the Twelfth to the Twentieth Century' (1930), 47 *LQR* 516 and (1932), 48 *LQR* 248 at 260–67), not to mention bills of exchange (see W Holdsworth, *A History of English Law*, 2nd edn (London: Methuen & Co, Sweet and Maxwell, 1937, reprinted 1966) vol VIII at 126–45 and 151–70).

<sup>184</sup> But cf A Motomura, 'The Best and Worst of Currencies: Seigniorage and Currency Policy in Spain, 1597–1650' (1994), 54 *The Journal of Economic History* 104, arguing at 123 that 'the Spanish Monarchy's currency policies in the early seventeenth century were fiscally rational in the context of prolonged warfare.'

<sup>185</sup> See N Ferguson, *The Ascent of Money* (New York: Penguin Press, 2008) at 19–23, 26; and Eagleton and Williams, above n 95 at 162–92.

2. THE MONETARY LEGAL THEORY UNDER THE TALMUD<sup>186</sup>

## 2.1 Introduction

Two fundamental principles of modern legal theory of money are nominalism and currency. Both refer to the object passing as money, and its use in payment of debts. Under the former, this object circulates and is tendered in the value of prescribed abstract units of account, as defined by law from time to time, regardless of its own intrinsic value, and regardless even of the obligation to redeem it in something of that intrinsic value.<sup>187</sup> Under the latter, this object passes from hand to hand in circulation free from adverse claims of prior owners.<sup>188</sup> A third principle, existing side by side with the two mentioned above, is the issue of the object under the authority of a State and its acceptance by the public at large.<sup>189</sup>

Way back in Antiquity, as discussed above in section 1, the coin emerged as an object used exclusively as money. From its inception and early development, the coin had been a piece of metal, stamped with a mark certifying its intrinsic value. Over the years, the shape became predominantly round and the mark predominantly came to be that of a figure, frequently the coin issuer, a State ruler. Under the then prevailing metallic theory, the coin circulated primarily by reference to the value of its metallic content. Hence, in its original and ‘purist’ form, metallism did not only signify the definition of money in terms of a standard measured by a prescribed quantity of a precious metal;<sup>190</sup> rather, it further related to the actual conformity of each coin, as the means of payment, to that standard.<sup>191</sup> Certainly, the prevailing principle was that of metallism and not nominalism.<sup>192</sup>

This section examines the treatment by the Talmud of the two fundamental principles of the modern legal theory of money. The section is thus designed to demonstrate the existence of a principle facilitating the currency of the coin, as

<sup>186</sup> For the Talmud and glossary of post-Talmudic Jewish law sources, see below, ch 4, n 1 and Appendix respectively.

<sup>187</sup> See eg C Proctor, *Mann on the Legal Aspect of Money*, 6th edn (Oxford: Oxford University Press, 2005) at 228.

<sup>188</sup> The classic case is *Miller v Race* (1758) 1 Burr 452, 97 Eng Rep 398, where Lord Mansfield stated (at 457, Burr; 401, Eng Rep) that money ‘can not be recovered after it had passed in currency’ so that ‘in case of money stolen, the true owner can not recover it, after it has been paid away fairly and honestly upon a valuable and bona fide consideration’.

<sup>189</sup> Both the State and societal theories of money are discussed by Proctor, above n 187, respectively at 15 and 23.

<sup>190</sup> In which form it subsisted as late as the nineteenth century CE. See A Nussbaum, *Money in the Law National and International: A Comparative Study in the Borderline of Law and Economics*, rev edn (Brooklyn: The Foundation Press, Inc, 1950) at 2.

<sup>191</sup> According to Rebuffat, above n 3 at 131, ‘it is a truism to affirm that the value of a coin primarily depends on the value of its metal from which it consists, its quality, and its weight.’

<sup>192</sup> For viewing nominalism as ‘[a] money conception which dissociates itself from the metallic element’ and thus as the antithesis of metallism, see Nussbaum, above n 190 at 17.

well as cracks in the metallic theory of money, that in retrospect heralded, 1,000 years later, the emergence of nominalism.<sup>193</sup> It will also demonstrate that the Talmud took for granted the third principle, that of issue by the State and acceptance by the public.

The Talmud contains passages reflecting a sophisticated multi-metal coin system.<sup>194</sup> At the time of the Talmud, coinage issued by Jewish rulers had been a matter of history;<sup>195</sup> coins under discussion are thus predominantly if not exclusively foreign, that is, not issued by Jewish rulers.<sup>196</sup> This explains the absence of an in-depth discussion of questions relating to the issue of coins. While Talmudic texts include extensive discussion on the legal nature of money in circulation, they do not discuss the power to mint or withdraw coins from circulation and related 'public law' questions.

While the Talmud draws on biblical sources, such reliance ought to be addressed in historical perspective. Indeed, as shown immediately below,<sup>197</sup> the Hebrew Bible<sup>198</sup> makes ample references to 'money'. At the same time, the period in question is well before the appearance of coined money.<sup>199</sup> Moreover, in Hebrew, one word, *'kesef'*, denotes both 'silver' and 'money'. Furthermore, in ancient times, units of account for payment and unit of weights were interchangeable.<sup>200</sup> On

<sup>193</sup> The landmark case is *Le Case De Mixt Moneys*, above n 167, characterized by Sargent and Velde, above n 15 at 105, as 'the ground-breaking decision on debt repayment.' The case is discussed in this chapter in section 3 below.

<sup>194</sup> For the elaborate currency system under the Talmud see eg A Steinsaltz, *The Talmud – The Steinsaltz Edition – A Reference Guide* (New York: Random House, 1989) at 290–92.

<sup>195</sup> Presumably, 'the earliest Jewish coinage to be excavated, identified by the inscription of "Judea" in Aramaic letters', is from the fourth century BCE. See Carradice, above n 8 at 55. I suppose that the first reference in Jewish sources to coin issue is in I Maccabees 15:6 where an account is given of the authority conferred (in the 130s BCE) by the Seleucid King Antiochus VII to Simon, Ethnarch of Judea, to 'issue special currency legal tender in [the] land'. For a mention of this source as well as of coins subsequently issued by the Hashmonean rulers of Judea after 103 BCE (and that did not bear any portrait in compliance with Jewish law forbidding human presentation) see eg Carradice, *ibid* at 84, and 94–95. The last issue of Jewish coinage in Antiquity is from the revolt of Bar Kochva during the first half of the second century CE. For an account of Jewish coinage in Antiquity, from the Maccabees until Bar Kochva's revolt, see eg Kadman and Kindler, above n 55 at 18–26.

<sup>196</sup> Cf Talmudic reference to 'the coin of Jerusalem' on which 'David and Salomon are on one side and Jerusalem the Holy City on the other side' as well as to 'the coin of our Father Abraham' in Talmud *Bava Kamma* at 97B, which is not to be taken as an account of historical coins. In his commentary on this reference, *ibid*, D'H 'David U-Shlomo', Rashi claims that reference is to coins bearing kings' names and not images, thus acknowledging lack of human presentation on Jewish coins, as in the preceding note. In light of the prohibition on human representation, the reference to the figure on coins as an element adding to their value, as discussed below in text at nn 217 and 231, is another indication to the exclusive treatment of foreign coins in the Talmud.

<sup>197</sup> List of sources is partial and does not purport to be exhaustive.

<sup>198</sup> The Hebrew Bible largely corresponds to the Christian Old Testament.

<sup>199</sup> Certainly, the Hebrew Bible purports to cover events that preceded the appearance of the coin in Lydia in the seventh century BCE.

<sup>200</sup> This is reflected in the correspondence between coins and weight units mentioned in the Talmud. See Steinsaltz, *Reference Guide*, above n 194 at 291, 293. To modern times, some currency names correspond to those of unit of weights. This is true eg for the dollar, pound, marc, dinar, and shekel. A contemporary extensive discussion on biblical weights in connection with the Talmudic currency system is by YG Weiss, *Midoth UMishkaloth Shell Tora (Tora Metrology)* (Brooklyn, NY:



occasion, it is obvious that a biblical reference to '*kessef*', even as a means of payment, is made to silver, to be weighed. This is so, for example, when the Patriarch Abraham weighs to Ephron 400 '*shekel kessef*' in payment of the Cave of the Machpela in Hebron.<sup>201</sup> However, elsewhere, the Bible is more ambiguous in referring to '*kessef*' as well as to units of which it consists as a medium of exchange for buying and selling,<sup>202</sup> to something which is lent,<sup>203</sup> in which valuation is made<sup>204</sup> and both prices<sup>205</sup> and penalties<sup>206</sup> are set and payments are to be made.<sup>207</sup> There is also a reference to '*kessef*' as something that, at least compared to agricultural produce, is easily bundled and hence portable.<sup>208</sup> At one point '*kessef*' is described as countable, hence, passing by tale.<sup>209</sup> It is also referred to as something that is more liquid than other items of property.<sup>210</sup>

Certainly then, biblical society knew units of account, even as they were interchangeable with units of weight. Moreover, close reading of the sources quoted above suggests the existence of objects that were regarded as media of exchange. The nature of these objects, and their proximity to coins, has been fiercely debated.<sup>211</sup> For its part however, being a text compiled and reflecting discussions that occurred while coins already constituted money, the Talmud easily seizes on the plain meaning of biblical sources as if they are truly dealing with coins.<sup>212</sup> On occasion, the Talmud even uses such sources as the basis for its own monetary legal theory.<sup>213</sup> Otherwise, they were used as validation for the use of coined money.

The Talmud examines issues relevant to the emergence of a legal monetary theory in various contexts. First, much on the features of money comes from the analysis of the money change transaction, that is, from the exchange of coins of one type with coins of another type. In such a transaction, coins of one set may

Moznaim Publishing, 1984) [in Hebrew] and SZ Reich, *Mesoras Hashekel* (Toronto: Kollel Publications, 1989) [in Hebrew].

<sup>201</sup> Bible, Genesis 23:16, which according to some translations, was 'current money with the merchant'. See eg *The Holy Scriptures According to the Masoretic Text* (Philadelphia: The Jewish Publication Society of America, 1955). See also Isaiah 55:2; Esther 3:9; Ezra 8:25–26.

<sup>202</sup> *Ibid* Genesis 17:23 and 27; Exodus 12:44; 21:21; Leviticus 22:11; Deuteronomy 2:6; 21:14; I Kings 21:2; Isaiah 1:22; 43:24; 55:1.

<sup>203</sup> *Ibid* Exodus 22:24; Leviticus 25:37.

<sup>204</sup> *Ibid* Leviticus 5:15; 27: 3–8, 15, 17, 19, 23, 25, and 27; Numbers 18:16.

<sup>205</sup> *Ibid* Genesis 33:19; Joshua 24:32; I Samuel 9:8; Isaiah 7:23; Jeremiah 32:9–10; Song of Songs 8:11; II Chronicles 1:17; 25:6.

<sup>206</sup> *Ibid* Exodus 21:32–35; 22:16; Deuteronomy 22:29.

<sup>207</sup> *Ibid* Exodus 30:12–15; Judges 16:5 and 18; Isaiah 52:3; Esther 3:11; Ezra 3:7.

<sup>208</sup> *Ibid* Deuteronomy 14:25–26 reproduced below in n 215 and discussed below in text around it. See also Proverbs 7:20.

<sup>209</sup> *Ibid* II Kings 12:10–12.

<sup>210</sup> *Ibid* Genesis 47:14–18.

<sup>211</sup> There is a scholarly disagreement on whether distinct items of value were actually used in the Ancient East exclusively as means of payments, and thus approximated coins. See n 86 above.

<sup>212</sup> See eg Talmud, *Kiddushin*, at 11A and 12A.

<sup>213</sup> See below discussion in text around nn 215–17, regarding Deuteronomy 14:22–26.



be treated as goods or merchandise<sup>214</sup> bought and paid for by coins of the other set; it is the coins of the latter set which are thus treated as money. In general, in a sale of goods transaction, it is not the payment of the price which causes the property to pass to the buyer, nor does it bind the parties. Rather, it is an act with respect to the goods which obligates the buyer to pay for them. Hence, in a transaction that entails the exchange of goods for money, it is important to identify what constitutes money and what constitutes goods. Certainly, in the sale of 'ordinary' goods, the identification of what constitutes goods and what constitutes money is simple; not so when the 'merchandise' is one set of coins paid for by another set of coins. It is in this context, then, that an intense discussion arises as to what set of coins is money relative to the other. In the course of this discussion, principal features of money are thus explored.

What constitutes money in the context of a money change transaction is important for the purpose of meeting an important religious obligation. Thus, in fulfilment of the duty to eat the harvest tithe in Jerusalem, one is commanded either to bring the original produce or to convert the produce to money, carry it to Jerusalem, and use it there to buy food to eat in Jerusalem. Permission to convert the produce for money is explicitly given on grounds of difficulties to carry the produce to Jerusalem. At the point of origin of travel, permission is given for the conversion of the produce into money, but not for the conversion of either money into produce or produce into produce.<sup>215</sup> Hence, when one converts fruit, being the original produce, to silver coins, and then to ease the burden of carrying the money to Jerusalem, exchanges the numerous silver coins for fewer more valuable gold coins, a question arises as to whether one effectively exchanges money for produce, which as indicated, is not allowed.<sup>216</sup> Whether a violation is present or not in that context is outside the scope of the present discussion; suffice it to say that the discussion is part of a broader one as to what is 'money' and what is a 'commodity' in the exchange between silver and gold coins.

At the same time, as part of the discussion on this religious commandment, the sages purported to define a principal feature of money. Thus, the requirement to bind the money in the hand was understood to mean that what constitutes 'money' must be amenable to be bound up, so as to be easily portable. Alternatively,

<sup>214</sup> Hereafter, 'goods', 'chattels', 'commodities', 'merchandise', 'products' and like words are to be used interchangeably.

<sup>215</sup> See Deuteronomy 14:22–26 re the obligation to bring a 'Maaser Shenì' to Jerusalem: 'Thou shalt surely tithe all the increase in thy seeds, that which is brought forth in the field year by year. And thou shalt eat before the Lord thy God, in the place which He shall choose to cause His name to dwell there, the tithe of thy corn, of thy wine, and of thine oil, and the firstlings of thy herd and of thy flock; that thou mayest learn to fear the Lord always. And if the way be too long for thee, so that thou are not able to carry it, because the place is too far from thee, which the Lord thy Lord shall choose to set His name there, when the Lord thy God shall bless thee; then shalt thou turn it into money, and bind up the money in thy hand, and shalt go unto the place which the Lord thy God shall choose. And thou shalt bestow the money for whatsoever thy soul desireth, for oxen, or for sheep, or for wine, or for strong drink, or for whatsoever thy soul asketh thee; and thou shalt eat there before the Lord thy God, and thou shalt rejoice, thou and thy household.' (Emphasis added.)

<sup>216</sup> For an extensive discussion, see Talmud, *Bava Metzia*, at 44B–45B.

or in fact complementarily, the Hebrew word for 'bind' is 'tzarta', from which it was concluded that a coin ought to bear the stamp of a figure or image, or in Hebrew, 'tzura'.<sup>217</sup>

A second context in which money is discussed is that of loan transactions. Thus, prices of commodities are set in money. Accordingly, one consequence of the biblical prohibition against charging and paying interest<sup>218</sup> is that in principle, only the lending of money, rather than other fungible chattels, is permissible. That is, due to possible fluctuation in the price of commodities, the loan of a fixed quantity of a commodity, in return for a promise to return the same amount of that commodity in the future, known as a loan of a bushel for a bushel or *se'ah* for a *se'ah*, is usually prohibited.<sup>219</sup> Conversely, since money is in what the price is set, fluctuation in the value of money does not lead to the violation of interest prohibition. Hence, a loan of money against a promise to return the same amount in money is permissible. At the same time, while as indicated, money may consist of coins of different metals, a debt is to be paid only at its value in the metal which, compared to all other metals, constitutes money. This is true even if the loan itself was incurred in coins of another metal. Otherwise, namely where silver coins are money compared to gold coins, repayment of a gold dinar for a loan made in a gold dinar, thus effectively linking the value of the debt to the value of gold in silver, would constitute a loan of a *se'ah* for a *se'ah* (of gold) and thus violate the interest prohibitions.<sup>220</sup>

In the third context, the Talmud deals with various scenarios involving damage caused to a coin, the deterioration of its metallic content, and the effect of its withdrawal from circulation or its demonetization by other means. Relevant discussions highlight important aspects of a monetary legal theory.

Finally, in a fourth context, treating money as a medium of exchange, namely, fungible chattels transferable from hand to hand, a doctrine emerged under Talmudic property law, effectively facilitating the circulation of coins. Thereunder, coins pass from one person to another free from prior owners' adverse claims.

<sup>217</sup> See Tosafot, D'H 'Asimon' in Talmud, *Bava Metzia* at 44A. The relevant biblical verse is quoted above in n 215.

<sup>218</sup> Prohibition is based on three biblical verses and exists for any transaction where a party is obligated to deliver or pay in genre. These biblical verses are Exodus 22:24, Leviticus 25:36–37, and Deuteronomy 23:20.

<sup>219</sup> The source of the prohibition is a Mishna in Talmud, *Bava Metzia*, at 75A which also mentions an exception to this rule where the borrower has in its possession the commodity at the time of the loan but it is inaccessible to him: 'Lend me . . . until my son comes or until I find the key.' *Ibid*. See eg also *ibid* at 63B, and *cf ibid* at 44B and 46A. The Talmud acknowledges that its position is contrary to the prevailing view in other legal systems under which the irregular deposit of fungible commodities is permissible. See eg *ibid* at 62A. Lending goods could however be lawfully carried out under the Talmud where their value is assessed at the time of the loan so that the borrower's obligation is to return the same type of goods in a quantity of the monetary same value at the time of the return. Mishna in Talmud, *Bava Metzia*, at 75A.

<sup>220</sup> See Talmud, *Bava Metzia* at 44B regarding the gold dinars lent to Rav by R' Chiya's daughter. In the fact of the case, the value of the gold dinar *actually* appreciated. Nemukei Yoseph, Rif, *Bava Metzia* at 26B, stating the prohibition to lend a gold dinar for a gold dinar *lest* its value will increase from 24 to 25 silver dinar, thus goes further.

The following discussion is divided as follows. Section 2.2 deals with coins as money and ordinary chattels and thus explores the nature of money in the context of an analysis of the money change transaction. Subsequently, section 2.3 discusses the fulfilment of an obligation to pay in money, with particular emphasis on the effect of erosion on the value of a coin; it presents the metallic theory of money under the Talmud. Finally, section 2.4 analyses the free transferability of a coin from hand to hand under Talmudic property rules as applied to money.

## 2.2 Coins as Money and Ordinary Chattels: The Legal Nature of the Money Change Transaction

Much on the features of money comes from the analysis of the money change transaction, involving the exchange of coins of one type with coins of another type.<sup>221</sup> As will be seen below, in such a transaction, one set of coins may be treated as money while the other may be treated as ordinary goods. Hence, the Talmudic analysis explores the features of money in the context of the rules applicable to the passage of property in the sale of goods.

The starting point in Talmudic law is that for property in a chattel<sup>222</sup> to pass from one person to another,<sup>223</sup> neither payment in money<sup>224</sup> nor mere agreement or words alone<sup>225</sup> will suffice.<sup>226</sup> Rather, the ownership of a chattel passes by means of a formalized procedure, in the form of a proprietary act, called a *kin-yan*, carried out in the object to be transferred.<sup>227</sup> Typical proprietary acts involve the change of possession; depending on the type of the object, such acts are *hagbaha* (lifting) and *meshicha* (drawing near or pulling) by the transferee, as well as *mesira* (delivery or handing over) by the transferor.<sup>228</sup>

And yet the Talmud facilitates the acquisition of a chattel by means of *chali-fin* or barter, namely, the exchange of two chattels, a procedure that involves a

<sup>221</sup> A comprehensive exposition of the moneychanger's business, who primarily changed money (for a fee) from one coin or denomination to another, including in another metal, is by A Gulak, 'The Moneychanger's Business According to Talmudic Law' (1931), 2 *Tarbitz* 154 [in Hebrew].

<sup>222</sup> Land is however acquired by payment in money, documentary note, or taking possession. See Talmud, *Kiddushin* at 26A.

<sup>223</sup> Words or payment will however suffice to consecrate property (rather than to transfer it to another person) to a religious trust. See Talmud, *Kiddushin* at 28B.

<sup>224</sup> See Mishna in Talmud, *Bava Metzia* at 44A. And yet, as explained in Beraitha, *ibid* at 48A, taking advantage of this rule is morally deplored. *Ibid.* (Transgressor is to obtain his retribution from Heaven.)

<sup>225</sup> One manifestation of this position, as well as the disfavour in which it has been viewed, is in Talmud, *Bava Metzia* at 48A, where a Beraitha is quoted to say that 'one who buys and sells with words [alone] has not acquired [anything] but the sages are not pleased with one who backs out [of] his verbal commitment.'

<sup>226</sup> Qualifications to this principle are alluded to in the paragraph that follows.

<sup>227</sup> See eg Talmud, *Kiddushin* at 22B, 25B–26A.

<sup>228</sup> See in general Talmud, *Kiddushin* at 25B (as well as 22B) and *Bava Batra* at 84B.

proprietary act in relation to only one of the chattels to be transferred.<sup>229</sup> One type of *chalifin* is that of *kinyan sudar*, or the transfer of ownership in a chattel by means of giving or drawing a kerchief. Under this procedure, the transferor of an object receives or takes from the transferee a kerchief, in return for which ownership passes to the transferee in the chattel to be transferred, while it is still in the possession of the transferor, and without any reference to a proprietary act in it.<sup>230</sup>

Coins, which constitute money, are physical objects. Like ordinary chattels, coins can thus be owned and physically transferred, as well as be valued on the basis of their metallic content. Nevertheless, unlike ordinary chattels, coins derive further value from their designated use as currency, by virtue of the image or figure imprinted on them, guaranteeing their weight and fineness, and hence their monetary value as media for exchange. Being thus distinguishable from other chattels, coins may neither be transferred by means of *chalifin*, nor serve as an instrument for acquiring other chattels by means of *chalifin*, rather than given in payment of chattels. This is so in part due to the requirement that for *chalifin* a utensil of use-value is required. Furthermore, since coins may be withdrawn from circulation, their monetary character, and hence value as money, is not stable, or in the language of the Gemara, 'the figure [thereon] tends to become obsolete.'<sup>231</sup>

A Mishna in *Bava Metzia*<sup>232</sup> analyses the money change transaction in the broader context of the sale of goods. Specifically, the Mishna seeks to identify which currency is the 'goods' and which is the 'money' in the transaction. This identification is required in order to determine the moment upon which the transaction is binding, which is when the 'goods' are drawn. Thus, in a transaction in which gold coins and silver coins are to be exchanged, it is the gold that 'acquires' the silver, namely, it is the drawing of the gold coins that binds their acquirer to pay with silver coins.<sup>233</sup> Stated otherwise, silver coins are the money and the gold coins are the goods; the transaction then is that of the sale of gold coins. Drawing the gold coins (the goods) finalizes the transaction so as to confer on the owner of the silver coins title to the gold coins, leaving the (unpaid) owner of the gold coins a claim against the owner of the silver coins. Conversely,

<sup>229</sup> For the broad principle under which 'all movables acquire one another' see Mishna in Talmud, *Bava Metzia* at 44A. For one implication see Mishna, *ibid* at 100A. Presumably however, a proprietary act in relation to one of the chattels to be transferred will suffice to transfer both chattels only as long as the parties have not assigned a specific monetary value to the chattels exchanged; where such value has been assigned a proprietary act must nevertheless be performed in each chattel. See *ibid* at 47A (Beraitha).

<sup>230</sup> For *kinyan sudar* see Talmud, *Bava Metzia* at 47A.

<sup>231</sup> The discussion in the Gemara on both points is however quite intense. See Talmud, *Bava Metzia* at 45B-47A. The quote is from *ibid* at 45B.

<sup>232</sup> At 44A.

<sup>233</sup> In stating that gold 'acquires' silver, the Mishna uses 'acquire' loosely; no specific silver coins are acquired at that moment; rather a claim to the payment of silver coins arises. Stated otherwise, the Mishna is to be read as saying that having taken the gold, the buyer becomes obligated to pay the silver. Talmud, *Bava Metzia*, at 45B.

silver does not acquire gold; drawing on the silver coins (money) will not finalize the transaction, and will not confer on the owner of the gold coins title to the silver coins. Both parties may still withdraw. Similarly, in a transaction contemplating the exchange of copper coins (*prutot*) and silver coins, the copper coins (goods) acquire the silver coins (money). Silver coins are thus 'money' by reference to both gold and copper coins.

The Mishna goes on to state that in a transaction contemplating the exchange of bad coins for good ones, the former are the merchandise and the latter are the money. 'Bad coins' are either (i) coins that were disqualified,<sup>234</sup> namely, either withdrawn by the Government or rejected by the population of a region,<sup>235</sup> or (ii) coins that had physically deteriorated.<sup>236</sup> Similarly, in a transaction contemplating the exchange of an *asimon* and a coin, the *asimon* is the goods and the coin is money. According to Rashi, '*asimon*' is a metal disk ready for minting, but which has not yet been imprinted.<sup>237</sup> Tosafot is however of the view that an *asimon* is a coin bearing a deficient image or imprint,<sup>238</sup> meaning a 'coin' that is not current, but is nevertheless worth, and exchangeable at, its metallic value.<sup>239</sup>

To a limited extent, both '*asimons*' and 'bad coins' circulate. According to Tosafot, the former circulate better than the latter,<sup>240</sup> and while both are chattels in relation to good coins, they are 'money' vis-a-vis other chattels. The monetary quality attached to '*asimons*' and 'bad coins' appears to apply to physically damaged coins,<sup>241</sup> coins rejected by the population in one region,<sup>242</sup> possibly coins with an effaced image,<sup>243</sup> as well as to circulating metallic disks. However, the monetary quality need not necessarily apply to 'bad coins' in the form of disqualified coins by virtue of withdrawal by the Government,<sup>244</sup> unless

<sup>234</sup> Rashi in Talmud, *Bava Metzia* at 44A, D'H 'Maot haraot'.

<sup>235</sup> For these two options, see Tosafot, *ibid* D'H 'Hazahav', by reference to BM at 46B.

<sup>236</sup> Tosafot, *ibid*; Chidushei HaRashba, *Bava Metzia* at 44A; and Nimukei Yoseph, Rif, *Bava Metzia* at 25A.

<sup>237</sup> Rashi, *Bava Metzia* at 44A D'H 'Asimon'.

<sup>238</sup> Tosafot, *ibid* D'H 'Hazahav' and 'asimon'. The deficiency may be a matter of bad or damaged imprint.

<sup>239</sup> See Chidushei HaRamban, as well as Chidushei HaRashba, both to *Bava Metzia* at 44A.

<sup>240</sup> Tosafot, Talmud, *Bava Metzia*, at 44A D'H 'Hazahav'.

<sup>241</sup> A crack in a coin is a discernible physical change which passes ownership in it to a thief, who thereby becomes liable to the owner for the return of its value at the time of the theft rather than for its return in specie. Talmud, *Bava Kamma*, at 96B (Mishna) and 97A–97B (Gemara). For damage as physical change see Talmud, *Gitin*, at 53B, Tosafot D'H 'Gazlan'.

<sup>242</sup> Rejection of a coin by local population in a region is certainly not a discernible change and thus does not pass ownership to a thief who thus remains liable to return it to the owner in specie. See Talmud, *Bava Kamma*, at 96B (Mishna) and 97A–97B (Gemara).

<sup>243</sup> According to Talmud, *Bava Kamma*, at 98A, this is not a visible physical change, so as to confer ownership on a thief and require him to return the value of the coin rather than the coin itself, though as Tosafot points out (*ibid* D'H 'Hashaf') this could be so only according to one who adheres to the position (indicated in the note that immediately follows) that withdrawal of a coin by the Government is not tantamount to a visible physical change.

<sup>244</sup> In which case it is disputed whether this withdrawal is tantamount to a visible physical change, so as to require a thief to return the value of the coin, or whether it does not amount to a physical change so as to leave the thief's duty to return the coin in specie unchanged. See Talmud, *Bava Kamma*, at 96B, 97A, and 98A.

they nevertheless circulate, albeit with difficulty, at the value of their metallic content.

In any event, vis-a-vis good coins, both 'asimons' and 'bad coins' are chattels.<sup>245</sup> Elsewhere, the Gemara is telling us that in the exchange between two purses of 'bad coins', each purse is merchandise.<sup>246</sup> One may speculate that the same is true for the exchange of two purses of 'asimons'. As between 'asimons' and 'bad coins' the Gemara is silent. It is likely either that whichever is in better circulation is the 'money',<sup>247</sup> or else, that both are chattels.

It is at that point that the Mishna states that regarding the sale of chattels, it is the chattels that acquire the coins, but the coins do not acquire the chattels. Stated otherwise, it is the proprietary act with respect to the chattels that obligates the buyer to pay for them; at the same time, a proprietary act with respect to the money would neither pass ownership to the chattel nor bind the parties to the contract. According to Tosafot, the Mishna here refers to chattels paid for with any type of coin, even gold or copper coins, good, bad or unminted; they are deemed coins relative to all movables that are not currency.<sup>248</sup>

The ensuing Gemara reports an earlier contrary position in relation to the Mishna under discussion according to which, between gold and silver coins, it is the gold coins that constitute money and the silver coins that are the merchandise.<sup>249</sup> The Gemara uses the occasion to discuss what are the decisive factors in assigning to some objects the quality of money in relation to others. The Gemara sets out two factors: easy circulation and hence greater acceptance on one hand, and added value to the metallic content by virtue of being money or currency on the other hand. The Gemara concludes that while silver coins circulate more easily than those of gold, the added value to the metallic content of gold coins is greater than that of silver coins, and hence there are conflicting views on what between the two constitutes money in relation to the other.<sup>250</sup> What ultimately has been preferred as the decisive factor is then the easy circulation, which further explains why silver coins are money not only in relation to gold coins but also in relation to copper coins.<sup>251</sup> Against the silence of the Talmud itself, there is however no consensus among commentators as to what constitutes money in a transaction in which copper coins are exchanged for gold

<sup>245</sup> Per the plain text of the Mishna in Talmud, *Bava Metzia* at 44A.

<sup>246</sup> Talmud, *Bava Metzia* at 46B, by reference to the exchange between two purses of disqualified coins, one full of coins withdrawn by the Government, and the other full of coins rejected by the local population of a region. *Quaere* as to the impact of the exchange of purses as opposed to coins per se on the ruling.

<sup>247</sup> Namely, 'asimons' according to Tosafot. At the same time, there is no indication that what Rashi considers as 'asimons' circulate at all, in which case, according to this interpretation, it would be the merchandise compared to the 'bad coins'. Assuming they are made of the same metal, unlike between coins of different metals, 'value' is not a factor in assessing which is 'money' between 'asimons' and 'bad coins'. Metallic difference will add another unknown to the question.

<sup>248</sup> Tosafot, Talmud, *Bava Metzia*, at 44A D'H 'Hazahav'.

<sup>249</sup> Which is the position reported in the Mishna in the Jerusalem Talmud.

<sup>250</sup> Talmud, *Bava Metzia*, at 44A–44B.

<sup>251</sup> *Ibid.*

coins. At the same time, it is agreed that in an exchange of coins of different denominations of the same metal, both sets are money so that the transaction is not finalized until each party draws what is tendered to him.<sup>252</sup>

### 2.3 Coins Valued on Basis of Metal: Effect of Erosion<sup>253</sup>

#### (i) *Introduction*

A creditor and debtor may agree on the type of coins in which a debt is to be paid.<sup>254</sup> Thus, if the agreed coins are to be freshly minted, the creditor may decline a tender of old coins even where the latter are of better quality.<sup>255</sup> The same is true for an agreement to pay with coins that are not current at the place of payment; in such a case, a tender of other coins, including those that are current in the place of payment, is invalid.<sup>256</sup> There is, however, a disputation in the case of a payment obligation to be made by coin<sup>257</sup> that thereafter, namely, prior to repayment, was disqualified.<sup>258</sup> According to one view, the debtor is to pay in a coin that passes as currency at the time of payment.<sup>259</sup> According to the contrary view, the debtor may<sup>260</sup> tender the disqualified coin, as long as it is acceptable somewhere else, though possibly, only as long as this is of any use to the creditor.<sup>261</sup>

By definition, a rule requiring the tender of a particular type of coin, whether agreed or current at the time or place of payment, reflects a shift away from strict orthodox metallism. The latter focuses solely on the metallic content of the coin. Nevertheless, also in this context of the impact of monetary changes on payment

<sup>252</sup> Shulchan Aruch, *Choshen Mishpat*, Section 203, Rules 3–7.

<sup>253</sup> Unless indicated otherwise, the ensuing discussion in section 3, as of the third paragraph below, on the Talmudist metallic theory of money, focuses on Talmud, *Bava Metzia*, at 51B–52B.

<sup>254</sup> Eg, they may prefer and hence agree on either heavy coins or coins recognizable and accepted in more locations (though of less weight), as well as on the delivery of the coins either bound or loose. Cf Talmud, *Bava Metzia*, at 108B. Similarly, they may agree on the type and quality of grain in which payment (typically for rent of farm land) is to be made. See eg Talmud, *Bava Metzia*, at 106A.

<sup>255</sup> Talmud, *Bava Metzia*, at 45B.

<sup>256</sup> Chidushei HaRitva, *Bava Metzia*, at 45B.

<sup>257</sup> Among commentators, there is no consensus as to when and whether the term as to the coin to be returned needs to be explicit. See eg in Talmud, *Bava Kamma*, at 97A, Rashi D'H 'Hamalveh et chavero' and 'Al hamatbea' and Tosafot D'H 'Hamalveh et chavero al hamatbea', as well as Nimukei Yoseph, Rif, *Bava Kamma*, at 35A D'H 'Matbea ve-chu'.

<sup>258</sup> Talmud, *Bava Kamma*, at 97A–97B. While in general, as indicated above in the text at nn 234–35, coin disqualification may be either by means of withdrawal by the Government or by the rejection by the local population in a region, the ensuing discussion points out that here the argument focused on the latter case, that of rejection by the local population in a region.

<sup>259</sup> Though in principle, as discussed immediately below, at the original value, in case of revaluation. Talmud, *Bava Kamma*, at 97B–98A.

<sup>260</sup> In other words, according to that view, the choice of the coin appears to be at the debtor's discretion.

<sup>261</sup> Eg, the creditor may engage in business in a place in which the agreed coin is still used, or else, may change coins, where this option is available. Talmud, *Bava Kamma*, at 97B.



obligations, metallism is not abandoned altogether. This can be seen from the discussion on the effect of either the re-valuation or the devaluation of a currency by varying the weight of a given denomination. In principle, in either case, to the extent that the creditor is paid with the new coins, he is mandated to take in discharge of the debt due to him the original metallic weight, namely a reduced number of re-valued coins in case of re-valuation, and an additional number of devalued coins in case of devaluation.<sup>262</sup> Indeed, as shown below, the prevailing monetary legal doctrine under the Talmud is metallic.

In demonstrating this feature of Talmudic law, of particular interest is the ability to pay with an eroded or even damaged coin that has lost some of its metallic content. Certainly, it is recognized that added value is conferred on a coin by the image imprinted on it;<sup>263</sup> and yet, it is contested as to whether this value is substantial. Indeed, the view that one is liable for diminishing the metallic content of his fellow's coin, but not for merely effacing its *image*, can be attributed only to the position that most of the coin value is derived from its metallic content.<sup>264</sup>

The metallic content of a coin may not, however, be constant. Coins that circulate heavily tend to erode from use and handling. An eroded coin does not have the same metal content as if it were a new coin of the same denomination; hence, it is less valuable. To use an eroded coin as if it were a new coin could therefore constitute fraud. The Mishna discusses the level of erosion at which the use of a coin would be fraud, and is followed by a Gemara analysing possible scenarios. Broadly speaking, coins fall into three categories:

1. Full-weighted coins or those that have eroded up to (and including) the limit of fraud<sup>265</sup> (according to Rava), and according to Abayee, even down to another Isar,<sup>266</sup> may be used at their face value. In the case of an eroded coin falling into this category, *quaere* as to whether the payer ought nevertheless to be prepared to make up the difference if the payee protests.
2. Coins eroded beyond that point, that is, beyond the fraud limit (and according to Abayee plus another Isar),<sup>267</sup> reduced to up to (and including) 50 per cent of their original weight, may be used at their actual weighted metallic value – at least at the 50 per cent point.

<sup>262</sup> Talmud, *Bava Kamma*, at 97B–98A. See elaborations in Nimukei Yoseph, Rif, *Bava Kamma*, at 35A; Rosh, D'H Bo Mineh, commenting on Talmud *Bava Kamma*, at 98A; Rambam, *Mishpatim: Hilchot Malveh ve-Loveh*, Section 4, Rule 11. Rashi is of the view (Talmud, *Bava Kamma*, at 98A D'H 'Le-inyan nascha') that in the case of re-valuation, the added weight of the original amount of (heavier) coins of the new (re-valued) currency will constitute prohibited interest. Note that where the new price in new revalued coins is the same as the old price in the original coins an adjustment in the amount to be repaid is to be made only as of 20% re-valuation.

<sup>263</sup> Talmud, *Bava Metzia*, at 44A–44B. See also at 45B. This added value was mentioned above in the text that follows n 230.

<sup>264</sup> Talmud, *Bava Kamma*, at 98A.

<sup>265</sup> For the various views on the limits of fraud see section 2.3(iii) below.

<sup>266</sup> A small-value coin worth eight Perutot and 1/24 dinar. See table in Steinsaltz, *Reference*, above n 194 at 292.

<sup>267</sup> For the various views on the limits of fraud see section 2.3(iii) below.



3. Coins reduced below 50 per cent of their original weight are to be demonetized, and may not be used as money.

The following discussion explains and elaborates on these rules.

(ii) *Deficient Coins as Money*

The Mishna states that the holder of an eroded coin may use it for deconsecrating *maaser sheni*, namely, transferring the sanctity of produce which ought to be taken and eaten in Jerusalem onto money to be taken to Jerusalem and used there to buy food.<sup>268</sup> The Mishna goes on to say that the holder of the eroded coin need not worry, for it is only one of an ungenerous disposition who refuses to take such a coin. This statement is taken by Rashi to refer to an erosion reaching the limit of fraud, and by Rav Papa in the Gemara to further apply to defective coins, such as those which are cracked or bent, provided such coins circulate, albeit with difficulty. An inconclusive discussion develops as to whether deficient coins used for deconsecrating *maaser sheni* are to be accepted at their actual or face value, and whether this is at the same exchange rate as when such coins are changed. Ultimately, the Gemara concludes, the Mishna does not deal with this point and is not to be taken to mean that the value of a deficient coin is to be inflated when it is used for the consecration of *maaser sheni*. Rather, according to Rashi, the Mishna that permits the use of a deficient coin to redeem *maaser sheni* means that the deficient coin is not to be demonetized, but rather is to be treated like a coin, that is, money, and as such is an acceptable medium of exchange. Stated otherwise, the deficient coin is not to be treated as a mere lump of metal, which is not a valid medium for redemption.

In sum, deficient coins that are permitted to circulate are to be treated as money. This is true at least for coins eroded to the limit of fraud.

(iii) *Erosion to the Limit of Fraud*

Elsewhere, the Gemara provides for the right of a defrauded party to a sale transaction. Whether the party is an overpaying buyer or an underpaid seller, he has the right either to rescind the contract and reverse the sale, or to have the price adjusted.<sup>269</sup> It is however recognized that in a sale of a commodity by measure, weight, or number, where the wrong quantity is actually delivered, the entire quantity is returnable.<sup>270</sup> This is true regardless of whether the quantity delivered is higher or lower than the quantity specified in the contract, and irrespective of whether the discrepancy is less than the standard amount for price fraud (which, as will be seen immediately below, is 1/6).<sup>271</sup> Presumably, this

<sup>268</sup> Deuteronomy 14:24–25, reproduced above in n 215.

<sup>269</sup> See eg Talmud, *Bava Metzia*, at 49B, 51A and 56B. Both latter texts cite Leviticus 25:14 as the source.

<sup>270</sup> Talmud, *Bava Metzia*, at 56B.

<sup>271</sup> *Ibid.* See also Talmud, *Kiddushin*, at 42B.

remedy is available to the buyer since it is natural for a person to insist that he receives the exact quantity for which he bargained; otherwise, the sale is mistaken.<sup>272</sup> Nevertheless, our Mishna<sup>273</sup> considers payment with a deficient coin, weighing less than its stated monetary value, as valid, as long as the deficiency falls within the rules pertaining to fraud. This may indicate that the coin is not weighed in each transaction, so as not to be something sold according to weight.<sup>274</sup>

The Mishna cites three positions as to the limit of fraud for coins. According to R' Meir it is 1/24 (four Isars to the Sela). According to R' Yehuda it is 1/12 (four Pundyons to the Sela) and according to R' Shimon it is 1/6 (eight Pundyons to the Sela).<sup>275</sup> After some discussion, the Gemara concludes that at the limit of fraud, whatever it is, the coin is still acceptable.

No resolution to the fraud limit for coins is given.<sup>276</sup> The Gemara observes that a controversy exists as to the critical fraction for fraud only as to a coin and not as to a garment, in which case all agree that the limit of fraud is 1/6. Two alternative explanations are provided for the discrepancy. According to the first explanation, the rule as to the garment is according to R' Shimon, who thinks that in both cases (garment and coin) the limit of fraud is 1/6. The alternative explanation is that the rationale for a fraud limit in garments is that people are prepared to overpay for garments.<sup>277</sup> At the same time, with a coin that does not circulate at face value when it is deficient, one does not forgo a deterioration of even less than 1/6. Thus, according to R' Meir, even a deficiency of 1/24 is significant.

The Mishna inquires as to the time limit for a defrauded party to return a defective coin and claim that it was unacceptably eroded at the time of payment. The Gemara's understanding is that beyond such a period, it is only a pious person who will accept the coin back even though he is under no obligation to do so.

The length of the period depends on the location where the fraud occurs: in cities the deadline is set by the time the defrauded party will show the coin to a moneychanger. Presumably, this is likely to happen promptly. In the villages, it is until Friday night (*Erev Shabbat*), which is considered to be a longer period. The

<sup>272</sup> See Rashi, Talmud, *Bava Metzia*, at 56B, D'H 'Chozer'.

<sup>273</sup> Talmud, *Bava Metzia*, at 51A–52B.

<sup>274</sup> Accordingly, where a coin is sold by weight, any small missing amount is deemed fraud. See Yachin U-Voaz, Mishna, *Bava Metzia*, Section 4, Rule 5.

<sup>275</sup> See table in Steinsaltz, *Reference*, above n 194 at 292.

<sup>276</sup> This issue is not fully resolved in the Talmud and even later commentaries disagreed on this point. Shulchan Aruch sides with the Rif and Rambam who take the opinion of R' Shimon, while Ramah sides with Rosh and Ramban, who side with Rav Yehuda. See Shulchan Aruch, *Choshen Mishpat*, Section 227, Rule 16 for a detailed account of the diverse views on this unsettled point.

<sup>277</sup> And yet not for food. Rashi explains that individuals buy clothes to protect the body even when they are expensive but they will not overpay for food. Talmud, *Bava Metzia*, at 52A, D'H 'Ashik legabecha' and 'Ve-shavei likresich'. But the 1/6 limit applies for also for items other than clothes (except for coins other than according to R' Shimon). Cf Tosafot, *ibid*, D'H 'Ashik legabecha'.

distinction must be premised on the absence of moneychangers in villages, wherein the local expert is the shopkeeper to whom the coin will be tendered in payment of food before the Shabbat.<sup>278</sup>

*(iv) Erosion Beyond the Limit of Fraud*

As noted previously, coins eroded beyond the limit of fraud are dealt with by reference to their weight. Accordingly, a Baraisa discussing the limit of fraud concludes by stating that if a coin is deficient beyond the limit (and according to Abayee, even down to another Isar),<sup>279</sup> the holder 'sells it for its worth', namely for actual present value according to its weight, rather than for face value according to its denomination.<sup>280</sup> Yet, this is so only where the erosion is up to 50 per cent. One may not retain as money a coin that eroded more than 50 per cent. Nor may he sell it even at its present value, 'neither to a merchant, nor to an extortioner, nor to a murderer'. This is so since payees are liable to deceive others with it. A merchant is liable to pass off such a coin to his customers as a good one, and a lawless person, such as an extortioner or murderer, may intimidate even a person who realizes the coin is deficient to accept it at the value at which it is tendered. Rather, the holder of a coin that eroded more than 50 per cent is under a specific obligation to demonetize it and destroy its appearance as a coin.

The 50 per cent erosion limit for the monetary use of a coin may be explained by the nature of the erosion process. That is, typically, the erosion of a coin affects its thickness, not the diameter that remains the same. Thus, the thinner appearance of an eroded coin plainly alerts people that it is not worth its full weighted value. At the same time, the large diameter of a coin might mislead people into thinking that it contains at least half of its weight, that is, half of its original value. Here lies the rationale for the prohibition to use a coin eroded more than 50 per cent as money, even at its actual weighted value, and the attached obligation to conspicuously demonetize it.

There is a debate about the treatment of a coin that has eroded to a point above the 50 per cent limit. R' Ami is of the view that its holder may use such a coin as money according to its true metallic value. Rav Huna disagrees. Possibly, he fears that a coin eroded less than 50 per cent, namely, so that its remaining metallic content is more than 50 per cent, may be misrepresented as a fully weighted coin circulating at its face value. Suspecting that such a misrepresentation may occur,

<sup>278</sup> A true expert is needed for coins but not necessarily for other chattels. Possibly, it is for this reason that in the case of fraud with respect to the value of goods sold, the time limit of an overpaying buyer is by reference to consultation with a merchant or relative. At the same time, in the case of fraud by a buyer of goods, there is no time limit on the right of the seller to raise his claim against the underpaying buyer, presumably, since the defrauded seller is out of possession. See Talmud, *Bava Metzia*, Mishna at 49B and Gemara at 50B–51A.

<sup>279</sup> The Isar is a small-value coin worth eight Perutot and 1/24 dinar. See table in Steinsaltz, *Reference*, above n 194 at 292.

<sup>280</sup> Talmud, *Bava Metzia*, at 52A.

he thus argues that coins eroded beyond the fraud limit (perhaps as adjusted by Abayee), are to be 'cut up';<sup>281</sup> presumably, demonetized. This is so at least as long as erosion beyond that limit is gradual, and has not reached the 50 per cent weight. At the same time, Rav Huna appears to concede that a coin reduced at once to 50 per cent of its value, such as by falling into fire, can be used as money in its present reduced weighted value. Commentators agreed with the rationale of Rav Huna. However, in purporting to follow him they interpreted his position with respect to erosion that left more than 50 per cent of the metal. Rav Huna is thus understood to require the holder to 'cut up', namely, eliminate, only the excess above the 50 per cent weight and keep this balance as metal, so as to use the remaining 50 per cent metallic content left in the coin as money worth its present metallic weighted value.<sup>282</sup>

There may be some controversy as to the fate of a demonetized coin. The principal Beraitha maintains that the holder of a coin that cannot be retained due to its excessive erosion beyond 50 per cent 'should pierce it and hang it as a pendant on the neck of his son or on the neck of his daughter.'<sup>283</sup> Stated otherwise, he is under a specific obligation to demonetize the deficient coin and destroy its appearance as a coin, upon which he is at liberty to use it as an ordinary chattel. This is stated to be supported by another Mishna.<sup>284</sup> Thereunder, a coin that was disqualified, namely, was either withdrawn by the Government from circulation or became heavily eroded, and used as a weight, is susceptible to become 'impure'; stated otherwise, the disqualified coin is considered to be a utensil, namely, an ordinary chattel, and not money. On the other hand, there is a discussion in our Gemara on the duty of the holder to cut the demonetized coin into two, that is, to destroy it altogether. More specifically, our Gemara brings another Beraitha precluding the holder of a coin that eroded beyond the retention limit from making it a weight among its weight or from throwing it among his piles of fragments of his silver utensils. Nor is he allowed to pierce it and hang it as a pendant on the neck of his son or the neck of his daughter. Rather, 'he should either grind it up, or melt it down, or cut it up, or bring it to the Dead Sea and throw it in.'<sup>285</sup>

Ultimately, our Gemara explains away the inconsistency by the nature of the physical act of demonetization. Thus, the first Beraitha is talking about piercing the coin in the middle, in which case demonetization is irreversible; a coin with a hole punched through it will not be accepted as currency. Conversely, the second Beraitha refers to piercing at the edge, in which case demonetization is reversible; the outer edge into which the hole was pierced might be removed and

<sup>281</sup> *Ibid.*

<sup>282</sup> See particularly Rambam, *Nezikin: Hilchot G'nevah*, Section 7, Rule 5 and the Magid Mishna there. See also Chidushei HaRitva, *Bava Metzia*, at 52B; Rif, *Bava Metzia*, at 31B and Pnei Yehoshua, *Bava Metzia*, at 52B.

<sup>283</sup> Talmud, *Bava Metzia*, at 52A.

<sup>284</sup> Keilim 12:7.

<sup>285</sup> Talmud, *Bava Metzia*, at 52B.

the coin may be passed on as money. In conclusion, an irreversible conspicuous demonetization transforms the coin to a chattel.

## 2.4 Property Rules Applicable to Coins: Facilitating Circulation

According to the Talmud, a person who finds a chattel having an identifying mark is required to announce, guard, and return it to the owner.<sup>286</sup> Conversely, a person who finds a chattel with no identifying mark need not publicly announce his finding and may keep the chattel for himself;<sup>287</sup> this is so since the original owner is deemed to have despaired from recovering a chattel that cannot be identified, thereby relinquishing ownership thereto.<sup>288</sup>

The application of the despair rules to the acquisition of coins requires further explanation. Thus, it is contested whether a relinquishment of ownership of any lost chattel requires the owner's awareness of the loss.<sup>289</sup> Stated otherwise, an issue arises as to whether a person who does not know he has lost a chattel is to be considered as abandoning it. The prevailing view is that without knowledge of the loss there is no abandonment by the person who lost possession and hence no acquisition by the finder.<sup>290</sup> In principle, this rule applies equally to coins as to any chattels.<sup>291</sup> However, it was observed that a person is likely to check his pocket frequently and hence to become aware very quickly that he has lost coins.<sup>292</sup> Hence, it is agreed that practically the finder of a coin, as a chattel without an identifying mark, is permitted to assume the owner's despair and hence be able to acquire it.<sup>293</sup>

At the same time, it is contested whether a thief, as opposed to a finder, may acquire a chattel based on the owner's despair at recovering it.<sup>294</sup> The prevailing view is that in any event an acquirer from the thief of a chattel whose owner despaired will acquire ownership. Acquisition by the acquirer from the thief is rationalized on the basis of a change of the domain (*'shinue rashuth'*) with respect to the chattel – from that of the thief to that of the acquirer from the

<sup>286</sup> The biblical source for the finder's obligation to return a lost chattel is Deuteronomy 22:1–3. See, Talmud, *Bava Metzia*, at 21A.

<sup>287</sup> Rambam, *Nezikin: Hilchot G'zela Ve-aveda*, Section 14, Rule 2.

<sup>288</sup> Rambam, *ibid.* Also see Rashi at Talmud *Bava Metzia* 21A, D'H 'Nithyashu Mihem'. Since the original owner cannot be identified, the question of the finder's possible liability to compensate him does not arise.

<sup>289</sup> See Talmud, *Bava Metzia*, at 21A–21B. The dispute is between Abayee and Rava.

<sup>290</sup> *Ibid* at 22B.

<sup>291</sup> Rambam, *Nezikin: Hilchot G'zela Ve-aveda*, Section 14, Rules 5 and 6.

<sup>292</sup> Rabbi Yitzhak in Talmud, *Bava Kamma* 118B.

<sup>293</sup> Talmud, *Bava Metzia*, at 21B, quoting with agreement Rabbi Yitzhak, *ibid.*

<sup>294</sup> Talmud, *Bava Kamma*, at 66A–68A. The view that the despair enables the thief to acquire the stolen chattel is adhered to by the Gemara in *Succah* at 30A (where the Gemara, per Rava, nevertheless rejects the view of an automatic despair upon a forcible robbery. The rejected view is that a forcible robbery victim, having been powerless to stop the robber in the first place, immediately, as he is robbed, despairs and abandons hope to recover the robbed chattel, so as to relinquish its rights to it, even when the chattel bears an identifying mark).

thief – which follows despair by the prior owner from whom the chattel had been stolen.<sup>295</sup> Any remaining doubts as to the acquisition by the taker from the thief do not seem to apply to a chattel that does not have an identifying mark, such as a coin.<sup>296</sup>

Good faith acquisition of a stolen object does not necessarily confer title on the acquirer. Accordingly, a good faith purchaser of a stolen object bearing an identifying mark may be required to return the object to the owner who has not despaired; and yet, having returned the stolen chattel, the purchaser may become entitled to be compensated by the owner.<sup>297</sup> As well, obtaining title to a stolen chattel does not necessarily release the new title holder from liability to pay compensation. Accordingly, ownership that may have been conferred on a thief does not excuse him from liability to pay compensation. A taker not acting in good faith, such as a purchaser from a notorious thief, is in the same situation;<sup>298</sup> presumably this is also the case for a purchaser who knows he is taking a stolen object. Each is liable to pay compensation regardless of whether ownership has been conferred on him.

At the same time, a bona fide purchaser of a stolen object, with respect to which the owner despaired, gets title and is not liable to pay compensation. One receiving stolen coins in good faith and as payment is thus protected, since the dispossessed owner is deemed to have despaired. Having acted in good faith, the payee has committed no wrong in becoming the new owner of the coins and is thus not liable to pay compensation.

A purse, whether empty or containing coins, and a pile of coins, may have identifying marks. An example for a set of coins that can be identified is where coins are neither scattered nor placed in a haphazard pattern, but rather stacked like a tower in a stable arrangement, such as where they are of different diameters with the largest coin at the bottom and smallest coin at the top. In such a case, it is evident that they were deliberately placed there by the owner. However, by itself, a coin has no earmark; stated otherwise, coins are fungibles; one cannot identify a lost coin by asserting its features as new or bearing the image of a particular king or emperor. Moreover, even a lost coin marked by the claimant with his own name does not bear a valid identifying mark, since the claimant

<sup>295</sup> Talmud, *Bava Kamma*, at 66A–68A.

<sup>296</sup> The remaining doubts are based on a Gemara in Talmud, *Bava Kamma* at 114A debating the duties of a robbery victim, to whom the robbers gave a substitute chattel robbed earlier from another person, to return the substituted chattel to the original owner. Rashi (*Ibid* D'H 'Im ba') speaks of a moral obligation (based on piety). The case is plainly distinguishable from that dealing with a voluntary (and usually innocent) transferee of a chattel with no identifying mark, such as a coin, who is unlikely to be able to trace the original owner. See also Tosafot in Talmud, *Bava Kamma* at 114A (D'H 'Tana') and in Talmud, *Bava Kamma* at 67A (D'H 'Amar Ula').

<sup>297</sup> In which case the owner has a recourse against the thief. See Rambam, *Nezikin: Hilchot Gne'va*, Section 5, Rule 2.

<sup>298</sup> See *Choshen Mishpat* Section 353, Rule 3.

may have paid with it; inevitably, once it went into circulation, the coin was thus subsequently lost by another person.<sup>299</sup>

Some commentators consider this rule as to the inadequacy of an identifying mark as neither absolute with respect to a coin nor necessarily limited to coins. Thus, Nimukei Yoseph<sup>300</sup> and the Ramban<sup>301</sup> do not rule out the possibility that a coin will bear an identifying mark, such as when it is cracked. Under such circumstances, the coin is to be treated as an ordinary chattel; presumably, even if a cracked coin is not necessarily demonetized, at least it does not circulate easily.<sup>302</sup> On his part, the Rashba does not rule out the possibility that a marked name even on an ordinary chattel will not be fit to serve as an identifying sign; this is so since the claimant may have sold the chattel marked by his own name so that now it belongs to another. And yet, as explained by the Ritva,<sup>303</sup> by their nature, coins are designed to be spent, that is, to pass on from hand to hand in circulation; hence, the rule is that a marked name on a coin is always inadequate to serve as a sign identifying the person whose name is marked on the coin as its owner at the time of the loss. At the same time, a marked name on an ordinary chattel will be inadequate to serve as an identifying sign only where that chattel stands to be sold.

Thus, the currency quality of a coin, namely its transferability from hand to hand free from the prior owner's adverse claims, is not explained in the Talmud on the basis of an *a priori* principle facilitating the free circulation in commerce of the coin, as under the more modern doctrine of English law,<sup>304</sup> fully discussed below in chapter eleven, section 6.2. Rather, transferability free from adverse claims is explained in the Talmud on the basis of the prior owner's relinquishment of ownership by way of despair. The despair leading to the relinquishment is, however, explained partially on the fungibility of the coin, and partly on its circulation. Circulation is thus a factor under both legal systems for the transferability of a coin free from adverse claims; however, under modern English law, facilitating the circulation of money is the motive for the special rule, while under the Talmud the circulation of money is only part of the reason for the rule.

As under the more modern doctrine of English law, a good faith taker for value of the coin is protected under the Talmud. However, in English law this is the full extent of the protection, which at the same time is absolute. In contrast, under the Talmud, due to the different theoretical rationale, at least according

<sup>299</sup> An extensive discussion is in Talmud, *Bava Metzia*, at 24B–25B. Among commentaries, in addition to Rashi, *ibid*, particularly see Rambam, *Nezikin: Hilchot G'zela Ve-aveda*, Section 14, Rule 10 (together with Magid Mishna and Lechem Mishna), as well as Section 16, Rule 3; Ha-Meiri, Beit Habchira, *Bava Metzia*, 25B.

<sup>300</sup> Nimukei Yoseph, Rif, *Bava Metzia*, at 14A, D'H 'She-ein siman le-matbea'.

<sup>301</sup> Chidushei HaRamban, *Bava Metzia*, at 25B.

<sup>302</sup> For the limited circulation of 'asimons' and 'bad coins' see above, paragraph containing nn 240–44.

<sup>303</sup> Chidushei HaRitva, *Bava Metzia*, at 25B.

<sup>304</sup> *Miller v Race*, above n 188 at 457 (Burr) and 401 (ER).

to one view, even a thief may be accorded a measure of protection. Certainly, a finder defeats the original owner of a coin. Again in contrast to English law, under the Talmud, in theory, there may be circumstances of a valid identifying sign on the coin that will preclude even a good faith taker from value from being protected. However, inasmuch as under the Talmud protection is usually accorded to a good faith taker for value, free circulation of coins is thus provided, even if under a crude legal theory.

## 2.5 Conclusion

The Talmud contains a sophisticated discussion on what constitutes money.<sup>305</sup> It has also produced a pioneering doctrine facilitating the currency of money by means of its transferability from hand to hand free of adverse claims.<sup>306</sup> As well, the Talmudic monetary legal theory is cognizant of both the State and societal theory: that is, a valid coin is to be sanctioned by the State as well as accepted by the public.<sup>307</sup>

At the same time, the Talmudic legal theory on the value of a coin is premised on its metallic content<sup>308</sup> and is thus a far cry from nominalism.<sup>309</sup> However, even in that respect, the Talmudic analysis is not monolithic. Thus, in discussing the distinct value of the figure stamped on the coin, the Talmud effectively introduces nominalistic elements into the doctrine governing coined money.

Indeed, a few exceptions to metallism are apparent throughout the Talmudic discussions. Thus, the disqualification of the coin as both an instrument and an object of *chalifin* has been based on a view that the value of the coin is unstable due to the reliance on the figure in the assessment of its value.<sup>310</sup> That same figure is however recognized as a source of the monetary character of the coin,<sup>311</sup> as well as, often, of its value.<sup>312</sup> Furthermore, the relative added value of the figure stamped on the coin is taken as a factor in the determination of the value of the coin which constitutes money in relation to another item of property.<sup>313</sup> All such considerations and discussions point to cracks in an orthodox metallic theory. The orthodox theory looks at the value of the metallic content as the exclusive source for determining the value of the coin. It is thus possible to conclude that, so far as the Talmud is concerned, a 'purist' metallic doctrine did not exist.

*Note:* For a glossary of Jewish law sources, see Appendix to Chapter 4.

<sup>305</sup> See particularly section 2.2 above.

<sup>306</sup> See particularly section 2.4 above.

<sup>307</sup> See sections 2.2 and 2.3(i) above.

<sup>308</sup> See particularly section 2.3 above.

<sup>309</sup> For nominalism see text at n 2 above.

<sup>310</sup> See above, text at n 231.

<sup>311</sup> See above, text at n 217.

<sup>312</sup> See above, text at n 231. See also text around nn 237–39 (*asimons* as money).

<sup>313</sup> See section 2.2 above, particularly the concluding paragraph.



### 3. FROM METALLISM TO NOMINALISM: EVOLUTION OF MONETARY LEGAL THEORY IN ROMAN LAW AND THE COMMON LAW OF ENGLAND

As indicated above at the beginning of section 2.1 of this chapter, two fundamental principles of modern legal theory of money are nominalism and currency. Neither Roman law nor known sources of Medieval law, whether in England or Continental Europe, appear to address the currency quality of money, namely, its transferability free from adverse claims.<sup>314</sup> At the same time, these legal systems contain discussions of either metallism or nominalism as the legal theory underlying money. Generally speaking, the prevailing thinking until the late Middle Ages was that of metallism. Nominalism became prevalent at the end of the Middle Ages and during the Renaissance. While nominalism is rooted in Romanist thinking, from a legal perspective, a decisive step of transformation from metallism to nominalism was also taken in England.

Roman law sources are thin on monetary legal theory.<sup>315</sup> First, the Digest speaks of the *mutuum*,<sup>316</sup> or ‘the case of loan for consumption’ in which the creditor does ‘not expect to get the very thing given . . . but rather something of the same kind.’<sup>317</sup> This covers ‘things which are dealt with by weight, number or measure’,<sup>318</sup> including coins or money.<sup>319</sup> Second, all such things equivalent, interchangeable or fungibles; hence, when they are lent for consumption, the debtor is required not to ‘give back some thing which though of the same kind, is of an inferior quality, for example, new wine for old wine.’ Rather, ‘the thing paid back must be of the same kind and quality as the thing given.’<sup>320</sup> However, third, elsewhere, the Digest speaks of money as a ‘constant medium of exchange’ of ‘stable value’ made of ‘material struck in due form by the mint’; as such, money ‘demonstrates its utility of title not by its *substance* as such but by its *quantity*, so that no longer are the things exchanged both called wares but one of them is termed the price’ (emphasis added).<sup>321</sup> Fourth, the Digest

<sup>314</sup> English law expressly stated this principle only in the course of the eighteenth century. See n 188 above and discussion in ch 11, section 6.2 below. According to D Fox, ‘Bona Fide Purchaser and the Currency of Money’ (1996), 55 *Cambridge Law Journal* 547 at 548, ‘[w]hen Lord Mansfield explained the currency of money in terms of bona fide purchase [in *Miller v Race* (1758), above n 188] he was not declaring a new rule. Rather he was expressing in a refined and principled way a rule which had been evolving in the common law during the previous 60 years.’

<sup>315</sup> The ensuing discussion in this subsection on Roman, Canon, and Medieval laws, as well as on the transformation in the underlying philosophy during the Renaissance, draws heavily on the discussion of Sargent and Velde, above n 15 at 69–107.

<sup>316</sup> Digest 12.1.2.2 reproduced (in both Latin and English) in T Mommsen, P Krueger and A Watson (eds), *The Digest of Justinian* (Philadelphia: University of Pennsylvania Press, 1985) vol 1 at 357. The *mutuum* is further discussed below in ch 5, section 2.

<sup>317</sup> Digest 12.1.2 reproduced in Mommsen, *ibid*.

<sup>318</sup> Digest 12.1.2.1 reproduced in Mommsen, *ibid*.

<sup>319</sup> See eg Digest 12.1.2.4, as well as 12.1.8, reproduced in Mommsen, *ibid* vol 1 at 357 and 358, respectively.

<sup>320</sup> Digest 12.1.3 reproduced in Mommsen, *ibid* vol 1 at 357.

<sup>321</sup> Digest 18.1.1 reproduced in Mommsen, *ibid* vol 2 at 513.

further states that ‘dud money’ in the form of false coins ‘does not discharge a payer.’<sup>322</sup>

The fourth passage is ambiguous; that is, falsification can be either with or without an impact on the intrinsic content of a coin. At the same time, the third passage contrasts ‘substance’ with ‘quantity’ or counting. It can easily be interpreted as viewing the value of the coin as derived from the figure, namely, from the quantity of unit of account as provided by the authority of the issuer, rather than from the qualities (such as weight and fineness) of the material from which the coin is made. As such, the third passage could have opened the door to nominalism. However, on the whole during the Middle Ages, Romanists overlooked this passage or interpreted it by requiring the quantity to be of items made of the substance. Particularly on the basis of the two first passages quoted above, Romanists adhered to metallism, viewing coins as metal objects, very much like grains of wheat, so as not to assign any value whatsoever to the figure imprinted on the coin.

Accordingly, Medieval Romanists thought that different pennies were the same thing in another form, and thus interchangeable, as long as they had not been debased. The same applied to multiple denominations. Unlike a boat which is wooden (but not wood) or cloths which are woollen (but not wool), coins are gold (but not golden), on the same footing as bullion is. Money was thus treated as a metal commodity. Tender of a different currency than the one contracted for can be rejected only upon showing loss by reference to metallic content. A debtor’s obligation was thus treated not by reference to a sum of money, or even specific coins; rather it was as an obligation to deliver a specific quantity of metal at a prescribed quality,<sup>323</sup> possibly but not exclusively in the form of coins.

During the Middle Ages, Canon law adhered to strict metallism. Thus, debased currency was considered to be false; hence, for example, a king who swore to maintain the currency only to discover that that currency had been secretly debased without his knowledge, was allowed to be relieved of his oath. Furthermore, net seigniorage, as opposed to brassage,<sup>324</sup> was decreed illegal, particularly when it was motivated by greed.<sup>325</sup>

However, cracks in this monolithic picture were soon to surface. Thus, the prevailing view was that demonetized coins were ‘dud’ so that their tender ‘does not discharge a payer’ as provided by the Digest,<sup>326</sup> regardless of their correct metallic content. Otherwise, in the later part of the Middle Ages, it was determined that debts are to be paid in coins of the type originally contracted. This precluded payment in any other type of coin, even when the latter had the same metallic content.<sup>327</sup> Obligations set in units of account rather than in a particular coin were interpreted to be payable at the currency reflecting

<sup>322</sup> Digest 13.7.24.1 reproduced in Mommsen, *ibid* vol 1 at 411.

<sup>323</sup> Nussbaum, above n 190 at 176.

<sup>324</sup> For this term see above, section 1.1, paragraph containing nn 20–24.

<sup>325</sup> Sargent and Velde, above n 15 at 90–92.

<sup>326</sup> See text and n 321 above.

<sup>327</sup> Where the original coins were demonetized ‘the debt was to be converted into current coins using the ratio of the original and current mint prices.’ Sargent and Velde, above n 15 at 89.

prescribed value at the time of payment. Finally, with the expansion of debasement practices, the Church came to recognize the validity of net seigniorage, as long as it was practised for the common good.

The idea that the value of a coin can significantly exceed that of its material, so as to lead to the theory of nominalism, is generally attributed to the sixteenth-century French lawyer and thinker Charles Dumoulin. In analysing the third passage from the Digest, he highlighted the distinction between ‘substance’ and ‘quantity’<sup>328</sup> to point at the distinction between the value of the coin as a piece of metal and as money. Thus, he accepted the fact that a coin is made of metal, but spoke of its assigned value as a medium of exchange, which is higher than the value of the metal. Indeed, he did not see the ruler’s power to assign the value as wisely used without any restriction, and specifically regarded the metallic value as the basis for the ruler’s wise exercise of the power; at the same time, he effectively recognized that a significant component in the value of the coin reflects its liquidity service as a means of payment. In his view, in exercising his power to set the value of a coin, the king is to ratify the true market value, reflecting both the metal and liquidity. He thus deplored debasement designed only to collect seigniorage. And yet, according to Dumoulin, individuals are to use a coin in the value assigned to it by the king, even where the king’s decision is wrong.

Dumoulin’s views prevailed in France and then crossed the English Channel. By way of background, coinage in Medieval England was controlled by the King.<sup>329</sup> The King could issue and withdraw coins<sup>330</sup> as well as make any foreign coin lawful money of England.<sup>331</sup> According to Blackstone, ‘as money is the medium of commerce, it is the King’s prerogative, as the arbiter of domestic commerce, to give it authority, or make it current.’<sup>332</sup> As late as the beginning of the eighteenth century, the Crown’s prerogative in relation to coinage was subject only to very little control.<sup>333</sup>

In fact, no unanimity existed as to the extent of the King’s power to control the metallic content of coins.<sup>334</sup> An unequivocal legitimization of that power is

<sup>328</sup> See text and n 321 above.

<sup>329</sup> Bolton, above n 166 at 73. For a detailed analysis, see Hale above n 3 at 187–98; and JL Wendell, *Blackstone’s Commentaries on the Laws of England* (New York: Harper and Bros., 1858) vol 1 at 274–78, 294–95. (Blackstone lived between 1723 and 1780.) See also TF Reddaway, ‘The King’s Mint and Exchange in London 1343–1543’ (1967), 82 *English History Report* 1.

<sup>330</sup> *Le Case de Mixt Moneys*, above n 167. The language of the report is French.

<sup>331</sup> *Wade’s Case* (1601) 5 Co Rep 114a, 77 ER 232 (CP).

<sup>332</sup> Blackstone, above n 329 at 276.

<sup>333</sup> See W Holdsworth, *A History of English Law* (London: Methuen & Co Ltd, 1938) vol X at 409.

<sup>334</sup> In the *Statute of Purveyors* 1353 (UK), 27 Edw. 3, c1, King Edward III bound himself not to worsen in fineness or weight the current coinage. Bolton, above n 166 at 298. According to Blackstone, the statute 1351 (UK), 25 Edw 3, c 13, established that all coined money must be made of ‘sterling’, namely of ‘the true standard’ of a given fineness of a given weight of gold or silver. He concluded that ‘the king’s prerogative seemeth not to extend to the debasing or enhancing the value of the coin below or above the sterling value.’ Blackstone, above n 329 at 278. Hale was less categorical. He concluded that ‘it is neither safe nor honourable for the king to imbase his coin below Sterling; if it be at any time done, it is fit to be done by assent of parliament’, Hale, above n 3 at 193.

*Le Case de Mixt Moneys*.<sup>335</sup> The case dealt with the discharge of an obligation to pay '100l. sterling, current and legal money.' The obligation was incurred in London, England and was to be performed in Dublin, Ireland. When payment became due, the debtor tendered 100l. in debased coins, issued by Queen Elizabeth I in 1576, between the date of the contract and that of payment.

At issue was the Queen's power to issue by proclamation debased coinage to be accepted in Ireland as sterling money. It was held that tender of the new debased coins was a good tender that could not have been rejected by the creditor. In hindsight, in this case '[t]he metallistic approach conception of debt definitely lost ground,'<sup>336</sup> so as to mark a shift in the common law from metallism to nominalism as the prevailing monetary legal theory.

In the course of the judgment, six elements were stated to be essential to the validity of a coin as a current and legal money:<sup>337</sup> (1) a fixed weight; (2) fineness or alloy; (3) impression (or stamp); (4) denomination; (5) authority of the prince; and (6) proclamation.<sup>338</sup> In the view of the Court, the prerogative of setting all these parameters for a coin, including that of fixing its value, is exclusively in the King's hands.<sup>339</sup> In reducing the value of a coin, the King has a complete and unfettered discretion,<sup>340</sup> even when debasement is carried out solely as a means to raise revenue.<sup>341</sup> While sterling currency is usually associated with a coin of high metallic quality,<sup>342</sup> the King has the prerogative 'to give value to base metal by his stamp . . . just as he may give estimation to a mean person and confer an honour on him.'<sup>343</sup> Stated otherwise, in setting the extrinsic quality for a coin, the King is not bound by its intrinsic quality.<sup>344</sup>

Certainly, the case did not go as far as to recommend to the King not to use discretion and economic wisdom in exercising the coining power; and yet, as a matter of law, the coining power emerged from the case as legally absolute and unrestricted. In retrospect, it was the potential for discrepancy between the extrinsic and intrinsic value of a coin, emanating from the exercise of the King's

<sup>335</sup> (1605) Davis 18, 80 E.R. 507.

<sup>336</sup> Nussbaum, above n 190 at 177.

<sup>337</sup> Above n 167 at Davis 19, E.R. 508. For a detailed discussion, see particularly Hale, above n 3 at 196, and in general at 187 ff. See also J Comyn (d. 1740), *A Digest of the Laws of England*, 3rd edn (London: T Longman et al, 1792) vol 5 at 94; and *Blackstone* above n 329 at 276–78.

<sup>338</sup> But cf *Pope v Leiger* (1694) Mod. 1, 87 E.R. 481; and *Dixon v Willows* (1701) 3 Salk 239, 91 E.R. 800, in which unproclaimed guineas were held to be 'current' (in the former case, *ibid*) and 'lawful . . . and current' (in the latter case, at Mod. 7, E.R. 485), arguably on the basis of acceptance in the community.

<sup>339</sup> Above n 167 at Davis 20, E.R. 508, 509.

<sup>340</sup> *Ibid* at Davis 22, E.R. 508, 510.

<sup>341</sup> *Ibid* Davis 22, E.R. 511 where the Court cites the Roman experience to that end during the First Punic War when Hannibal occupied a large part of Italy. The Roman treasury was exhausted so that it became necessary to issue debased money to cover soldiers' wages. (However, for the sake of historical accuracy, it should be noted that Hannibal's invasion of Italy took place in the Second Punic War which lasted between 218 and 201 BCE, and not during the First Punic War which lasted between 264 and 241 BCE.)

<sup>342</sup> *Ibid* Davis 23, 25; ER 511, 513.

<sup>343</sup> *Ibid* Davis 25, ER 513.

<sup>344</sup> *Ibid* Davis 24, ER 513.

unlimited power, which underlay the breakaway from metallism and heralded nominalism.

#### 4. CONCLUDING REMARKS

In the final analysis, currency doctrine, conferring title on a bona fide taker for value of money, was slow to emerge. In the absence of a distinctive sign or 'ear-mark' on a coin, an owner deprived of possession was in no position to identify it in the hand of another and thus was practically precluded from suing for its return. Hence, one may speculate, until the emergence of the banknote in the seventeenth century, there was little incentive for the development of a currency doctrine.<sup>345</sup> A notable exception, however, is the Talmudic legal doctrine for currency based on the despair of an owner out of possession.

Conversely, legal systems developed an extensive body of legal theory underlying the use of money in payment of debts. Legal theory evolved in tandem with developments as to the monetary objects. In this context, the legal history is that of transformation from metallism to nominalism.

Upon reflection, metallism, in its strict and orthodox form, contained the seeds for its own demise and thus was doomed to fail. As indicated, a coin is more than a piece of metal; indeed, it is a product made of metal, but it is also a product on which liquidity service is conferred. Hence, by definition, the value of a coin is higher than that of the piece of metal from which it is made. Equality between the value of a coin and the metallic piece from which it is made is a fiction. Moreover, demand to enhance liquidity, beyond available metallic resources, was on its own bound to lead to debasement and hence, ultimately, to nominalism.

As already pointed out,<sup>346</sup> whether scarcity of monetary objects produced payment mechanisms that resulted in the reduction of the transportation of monetary objects, or whether payment mechanisms were consciously set up to reduce the transportation of monetary objects so as to bring about a reduction in the amount of actual money in circulation, is a kind of chicken-and-egg problem. Historically, the emergence of payment mechanisms addressed both concerns. Thus, scarcity of money both impacted monetary objects, and either impacted or was impacted by the development of substitutes for them.

<sup>345</sup> On this point I am in full agreement with Fox, above n 314 eg at 549, 554. Conversely, each banknote bears a distinctive identifying number or other sign. *Ibid* eg at 556. This is fully discussed in ch 11, section 6.2 below.

<sup>346</sup> See above ch 1, section 4.1(i).

### 3

## Funds Transfers in Antiquity: Instruments, Institutions and Mechanisms

|                        |     |
|------------------------|-----|
| 1. Introduction        | 116 |
| 2. Ancient Mesopotamia | 118 |
| 3. Ancient Greece      | 124 |
| 4. Ancient Rome        | 132 |
| 5. Greco-Roman Egypt   | 140 |
| 6. Summary             | 155 |

### 1. INTRODUCTION

PAYMENT SERVICES ARE an outgrowth of deposit taking. In turn, it is the availability of deposited funds for lending to third parties which makes deposit taking profitable to a depositary. Hence, deposit giving becomes cost-efficient to the depositor, to whom the depositary will pass some of the profits, in the form of cost saving, with the view of attracting more deposits. Thus, the evolution in Antiquity<sup>1</sup> of mechanisms for payments initiated by the issue of payment orders had been part and parcel of the emergence of 'banking' as a form of financial intermediation between depositors to, and borrowers from, the depositary. Indeed, incentives for keeping money with depositaries and using it for making payments to third parties exist even where the depositary does not lend out of them in his own name; historically, also a depositary who did not lend was to provide payment services. Nevertheless, in the long run, the process of taking deposits, lending them, and allowing them to be used by the depositors in payment to third parties, turned the depositary into a bank.<sup>2</sup> In this process of transformation and growth, non-cash funds transfers initiated by payment orders flourished.

<sup>1</sup> Roughly speaking, Antiquity comes to an end with the beginning of the Middle Ages, usually marked by the fall of Rome in 476 CE.

<sup>2</sup> For an insight into the process, though well into the later Medieval period, see eg AP Usher, *The Early History of Deposit Banking in Mediterranean Europe* (Cambridge, Mass: Harvard University Press, 1943) vol I particularly at 3–25.

Coverage in this chapter is given to instruments, institutions and mechanisms in major centres of Antiquity, namely Mesopotamia, Greece, Rome, and Egypt.<sup>3</sup> Certainly, requirements of mechanisms in each centre had to be met by legal principles and rules to govern them. In the course of the ensuing discussion in this chapter, legal aspects are touched upon; it is however beyond the scope of the present study to analyse the payment order under all legal systems of the Ancient World.

Rather, subsequent chapters (four, five and seven) cover Talmudic and Roman Laws.<sup>4</sup> In the absence of a specialized body of law governing the payment order both exclusively and comprehensively, the choice of these two legal systems is predicated on the extent of available sources as well as on the richness of relevant legal discussion under each of them, both in quantity and sophistication.

Additional separate reasons for the paramountcy of each of these two legal systems are to be set out as follows. To begin with, as will be demonstrated in chapter four below, the origins of the modern-day cheque are said to be traced to a Talmudic discussion, which thus merits a detailed analysis. Furthermore, as will be seen below in chapter seven, in the early Middle Ages, principles of Talmudic law came to handle Islamic payment instruments, the forerunners of the bill of exchange. There is thus a particular interest of the treatment of payment orders under the Talmud.

For its part, the choice of Roman law is predicated on several distinct considerations. First, Roman law is the cornerstone of subsequent and present day legal systems of Continental Europe and numerous jurisdictions worldwide that have adopted civil codes, or principles derived from the Roman legal system.<sup>5</sup> At its inception, English common law also drew on Roman law sources.<sup>6</sup> In turn, as will be set out below in chapters eight and nine, the bill of exchange is known to originate in Continental Europe, and was subsequently exported to England. As will be pointed out in chapter eight below, Roman law is a focal point for a discussion on the legal principles under which the bill of exchange originated. Moreover, along lines discussed below in chapter twelve, sections 3 and 4, modern code provisions and principles governing payment orders in major civil law

<sup>3</sup> Development of banking in the Ancient World is succinctly summarized in H Cancik and H Schneider (eds), *Brill's New Pauly Encyclopaedia of the Ancient World: Antiquity*, (Leiden-Boston: Brill, 2003) vol 2 at 484 (v, 'Banks') and is outlined in greater detail in R Bogaert, 'Banking in the Ancient World' in H Van Der Wee and G Kurgan-Van Hentenryk (eds), *A History of European Banking* (Antwerp: European Investment Bank Mercatorfonds, 2000) Part I at 13–69 (hereafter: Bogaert, *History*).

<sup>4</sup> Muslim law is examined in ch 6. Certainly however, Islam and its legal system arose in the seventh century CE, subsequent to Antiquity, and hence no mention of them is made in the accompanying text or anywhere else in this chapter.

<sup>5</sup> Civil codes exist not only in former colonies of European powers throughout the world, but also in countries that came into contact with European powers such as China and Japan. Civil law principles without formal codes dominate the legal systems of Sri Lanka and South Africa.

<sup>6</sup> See eg a summary of the debate as to the Roman law influence on Bracton, in CHS Fifoot, *History and Sources of the Common Law: Tort and Contract* (London: Stevens & Sons, 1949) at 218–220.

jurisdictions derive from Roman law. The reach of Roman law, in time as well as space, is impressive. In that sense, Roman law overshadows all other legal systems of the Ancient World.

Second, as Antiquity drew to an end as a historical period, Roman power and influence spread throughout the entire Ancient World. As contemporary civilizations lost their pristine nature, their own legal systems came to absorb Roman elements, so that Roman law became a major legal system throughout the Roman Empire.<sup>7</sup> However, the reverse also occurred, leading to the third reason for focusing on Roman law: that Roman law itself incorporated elements of other, co-existing legal systems. At the zenith of Roman power and influence, Roman law may have lost any measure of insularity it had. Having interfaced and interacted with the other legal systems of the Ancient World, it certainly assimilated many of their salient aspects.<sup>8</sup> Thus, principles of Roman law as they had been transformed from time to time, either prevailed or had influence throughout the Roman Empire since its establishment, and into or even beyond its ultimate collapse. Such principles had come to be the most inclusive of, and the better preserved among, the pertinent elements of legal systems of the entire Ancient World.

## 2. ANCIENT MESOPOTAMIA

Mesopotamia is the land between the rivers Tigris and Euphrates that in Ancient Times created the eastern part of the Fertile Crescent in the midst of surrounding desert.<sup>9</sup> Its area roughly covers that of modern-day Iraq, though in its glorious times the power and influence of its rulers extended far beyond, into Asia Minor to the north, and reached the Mediterranean to the west.<sup>10</sup>

<sup>7</sup> For the incomplete 'Legal Romanisation of the Near East' see also P Crone, *Roman, Provincial and Islamic Law* (Cambridge: Cambridge University Press, 1987) at 92.

<sup>8</sup> This view is lucidly presented and elaborated by E Revillout, *Les Obligations en Droit Égyptien* (Paris: Ernest Leroux, 1886) throughout the Introduction (at ix–lxxxiii). For this mutual process, namely, for the 'gradual Romanization of the local law' as 'counterbalanced by a similar Hellenization of the Roman law' see also R Taubenschlag, *The Law of Greco-Roman Egypt in Light of the Papyri 332 BC–640 AD*, 2nd edn (Warszawa: Państwowe Wydawnictwo Naukowe, 1955) at 46. At 50 that author expresses his view that 'In the field of commercial law the influence of local law on Roman law was powerful.'

<sup>9</sup> The 'Fertile Crescent' is like a great arc of cultivable land that extends from the Persian Gulf, up and around Mesopotamia and back down to the Levant (roughly Biblical Phoenicia and Canaan, or modern-day coastal Syria, Lebanon and Israel) and Egypt (along the Nile). A map of the Ancient Fertile Crescent can be found online, eg at: [www.bible-history.com/maps/maps/map\\_ancient\\_fertile\\_crescent.html](http://www.bible-history.com/maps/maps/map_ancient_fertile_crescent.html).

<sup>10</sup> For the history of Mesopotamia see G Roux, *Ancient Iraq*, 2nd edn (Harmondsworth, Middlesex, England: Penguin, 1980). For a brief outline visit [www.it.stlawu.edu/~dmelvill/mesomath/history.html](http://www.it.stlawu.edu/~dmelvill/mesomath/history.html). For the economic order, see JN Postgate, *Early Mesopotamia: Society, Economy at the Dawn of History* (London, New York: Routledge, 1992; reprint with revisions 1994) at 155–222.



Ancient Mesopotamia has been identified as the ‘cradle of banking operations’.<sup>11</sup> It earned this title due to the emergence of institutions providing all core banking activities, namely, deposit taking, lending and payment services. A complex system of lending is traced back in Mesopotamia to the first half of the second millennium BCE.<sup>12</sup> However, in Ancient Mesopotamia, credit was made available by depositaries out of their own capital and without dipping into deposits, so that deposit taking had not turned yet into banking.<sup>13</sup> Lending, deposit taking and payment services were carried out as a ‘secondary activity’ by temples, palaces, merchants, and landowners, ‘that is to say, [by] all those in possession of capital.’<sup>14</sup> Thus, the appearance of banking operations in Ancient Mesopotamia led neither to the emergence of banking, in the full sense of the word, nor to the appearance of banks as distinct institutions. In short, limited banking activity historically preceded both banking and banks.<sup>15</sup>

There is a historical debate on the possible origins of money in the Ancient East, particularly in Mesopotamia; specifically, there is a disagreement on whether distinct items of value were actually used exclusively as means of payment, and thus approximated coins.<sup>16</sup> However, it seems to be universally agreed that nascent ‘banking operations’ in Mesopotamia preceded the emergence of money, in the sense of standardized metallic pieces, in fixed denominations,

<sup>11</sup> R Bogaert, *Les Origines Antiques de la Banque de Dépôt* (Leyde: AW Sijthoff, 1966) at 129 (hereafter: Bogaert, *Les Origines*). Roughly speaking, at 41–129, Bogaert surveys a period extending over 1500 years commencing at the end of the twenty-first century BCE and covering the Ur III Empire (2112–2004 BCE), the Old Babylonian Period (2000–1600 BCE) which included the reign of Hammurabi (1792–1750 BCE), the middle Assyrian and Middle Babylonian Periods (1200–750 BCE), and the Neo-Assyrian and Neo-Babylonian Kingdoms (745–539 BCE). Elsewhere in the book, *ibid* at 43, Bogaert specifically discounts the existence of any comparable role to Pharaonic Egypt, the other Ancient Near Eastern civilization.

<sup>12</sup> See in general, K De Graefe, ‘Giving a Loan is Like Making Love . . .’ in K Verboven, K Vandorpe and V Chankowski (eds), *Pistoi Dia Tèn Technèn-Bankers, Loans and Archives in the Ancient World: Studies in Honour of Raymond Bogaert* (Leuven: Peeters, 2008) at 3 (hereafter: Verboven et al, *Ancient World*).

<sup>13</sup> The gradual erosion during the first millennium BCE, culminating approximately at the first part of its second half, is noted by F Joannès, ‘Les activités bancaires en Babylonie’ in Verboven et al, *Ancient World*, *ibid* at 17, 19.

<sup>14</sup> Bogaert, *Les Origines*, above n 11 at 174.

<sup>15</sup> See Bogaert, *Les Origines*, *ibid*, particularly at 65–66, 75–76, 126–29, and 174–75. The summary of G Davies, *A History of Money from Ancient Times to Present Day*, 3rd edn (Cardiff: University of Wales Press, 2002) at 48–52, is generally in line with Bogaert’s extensive account, except that Davies is more definitive as to the evolution of deposit receipts into ‘transfers to the order not only of the depositors but also to a third party.’ *Ibid* at 50.

<sup>16</sup> Proponents include M Balmuth, ‘The Monetary Forerunners of Coinage in Phoenicia and Palestine’ in A Kindler (ed), *The Patterns of Monetary Development in Phoenicia and Palestine in Antiquity* (Tel Aviv: Schocken, 1967) (Proceedings of the International Numismatic Commission, The Israeli Numismatic Society, International Numismatic Convention, Jerusalem 1963) at 25; M Balmuth, ‘The Critical Moment: The Transition from Currency to Coinage in the Eastern Mediterranean’ (1975), 6 *World Archeology* 293; and J Dayton, ‘Money in the Near East Before Coinage’ (1974), 23 *Berytus Archaeological Studies* 41. For a critique see MA Powell, ‘A Contribution to the History of Money in Mesopotamia prior to the Invention of Coinage’ in B Hruška and G Komoróczy (eds), *Festschrift Lubor Matouš* (Budapest, Eötvös Loránd Tudományegyetem, Ókori Történeti Tanszék 1978) vol 2 at 211. Another skeptic is P Grierson, *The Origins of Money* (London: The Athlone Press, 1977, being the Creighton Lecture in History, 1970) at 8 and fn 7.

whose value is certified by the ruler's stamp.<sup>17</sup> Rather, under a complex monetary system, various commodities served as both units of account and means of payment. Thus, such commodities first served as a basis for a price system, based on their comparative or relative value. Second, such commodities served as actual means of payment. Principal commodities were grain and precious metal, usually barley and silver.<sup>18</sup> Having both (i) actual use value or intrinsic utility, and (ii) economic value facilitating their use to provide a standardized means for both the measurement for the value of other commodities as well for paying for all such other commodities, such items constituted 'primitive money'.<sup>19</sup> Deposits of such commodities were taken for both storage and safe-keeping, in anticipation of depositors' withdrawals primarily for actual use as grain or metal. However, as explained further below, payment orders, either for withdrawals from such depositaries, or to debtors of such commodities, could have been given also with the view of effectuating payments to third parties.

Deposit-taking activity for individuals by temples and palaces in Mesopotamia was limited.<sup>20</sup> Most such activity was undertaken by private depositaries and organizations of public character. The former belonged to individual affluent merchants<sup>21</sup> while the latter were operated by centralized mercantile organizations.<sup>22</sup> Thus, private granaries in Mesopotamia accepted deposits of barley or other grains for storage.<sup>23</sup> Public granaries operated by the authorities handled

<sup>17</sup> For the origins of metallic money in Lydia around the seventh century BCE see ch 2, section 1.2 above.

<sup>18</sup> See in general RFG Sweet, *On Prices, Money and Money Uses in the Old Babylonian Period* (Unpublished PhD dissertation submitted to the Department of Oriental Languages and Civilizations of the University of Chicago, IL, 1958, available through UMI Dissertation Services, Ann Arbor Michigan); and MA Powell, 'Identification and Interpretation of Long Term Price Fluctuations in Babylonia: More on the History of Money in Mesopotamia' (1990), 17 *Altorientalische Forschungen* 76. See also JN Postgate, above n 10, who in discussing (at 202–205) currency, observed (at 204) that 'In the early second millennium, silver was the preferred currency of the merchant classes and perhaps of the administration, but even in the Old Babylonian times . . . the administration and the private sector regularly used [also] barley to fulfil much the same function, and other commodities are also attested.'

<sup>19</sup> According to P Einzig, *Primitive Money*, 2nd edn (Oxford: Pergamon Press, 1966) at 317, primitive money was 'a unit or an object conforming to a reasonable degree to some standard of uniformity, which is employed for reckoning or for making a large proportion of the payments customary in the community concerned, and which is accepted in payment largely with the intention of employing it for making payments.' For primitive money see also AJ Toynbee, *A Study of History*, Abridgement of Volumes VII–X by DC Somervell (London: Oxford University Press, 1957) at 60 and in this study, ch 2, section 1, particularly section 1.2 above.

<sup>20</sup> Bogaert, *Les Origines*, above n 11 at 65–66 (for temples) and 75–76 (for palaces).

<sup>21</sup> According to Bogaert, *Les Origines*, *ibid* at 105, banking operations of affluent merchants became prevalent during the Neo-Assyrian and Neo-Babylonian Kingdoms (745–539 BCE). For deposit taking see *ibid* at 111–14 and 118–20.

<sup>22</sup> For the *kārum* as 'an organization of a public character', particularly of the Assyrians, being 'the mercantile centre of the city and . . . the organization which directs the activities of the merchants, a sort of chamber of commerce' and its activity, including deposit taking, see Bogaert, *Les Origines*, *ibid* at 83–85 and 128. Public granaries and warehouses operated by public authorities were not heavily involved in taking deposits from individuals. Bogaert, *Les Origines*, *ibid* at 66–67 and 75.

<sup>23</sup> Bogaert, *Les Origines*, *ibid* at 97–100.

storage and disbursements by the Government.<sup>24</sup> Organizations of public character operated warehouses for the safekeeping of precious metal, particularly silver, and fungible goods.<sup>25</sup> On occasion, a loan could have been disguised as a deposit.<sup>26</sup> Features of contracts for the storage of grain as well as of contracts for the safekeeping of silver or gold, including a depositary's liability in case of theft or loss of the deposited property, were provided for in applicable ancient legal texts,<sup>27</sup> such as the Laws of Eshnunna<sup>28</sup> and the Code of Hammurabi.<sup>29</sup>

A depositor could issue to the granary or warehouse either withdrawal orders or instructions to deliver barley or silver to designated third persons. The latter instructions were in effect payment orders. A depositary ran an account for each depositor. A depositor's account was credited for each deposit and debited for each withdrawal made either by himself or by a third party under the depositor's authority. However, it may well be that individual deposits were not mixed but rather kept separately for each depositor, so that each debit or credit actually involved a decrease or increase in the amount of barley or silver physically kept in the relevant separate deposit.<sup>30</sup> Furthermore, even where both depositors, respectively acting as a payer and payee, held their barley or silver with the same depositary, there appears to be no evidence for 'non-cash' payments. In theory, such 'non-cash' payments could have been executed by merely debiting the payer's account and crediting the account of the payee, even with fungible barley or silver physically transferred by the depositary from the deposit of the payer to that of the payee. In the absence of evidence for such transactions, it appears, for payment to be carried out, the payee had to attend in person and withdraw in kind or specie, though of course he could add the barley or silver he had withdrawn from the payer's account to his own deposit. All withdrawals and deposits may thus have been made in kind or specie.<sup>31</sup>

<sup>24</sup> Bogaert, *Les Origines*, *ibid* at 66–67 and 75. And yet they were not heavily involved in taking deposits from individuals.

<sup>25</sup> Bogaert, *Les Origines*, *ibid* at 84–85 and 128.

<sup>26</sup> Bogaert, *Les Origines*, *ibid* at 98.

<sup>27</sup> A collection of laws is found in JB Pritchard, *Ancient Near Eastern Texts Relating to the Old Testament*, 3rd edn with Supp (Princeton, NJ: Princeton University Press, 1969).

<sup>28</sup> Sections 36 and 37 which did not distinguish between storage of grain and the safekeeping of other types of property. Presumably, Laws of Eshnunna preceded Hammurabi's Code by some 200 years. See R Yaron, *The Laws of Eshnunna*, 2nd rev edn (Jerusalem-Leiden: Magnes Press-EJ Brill, 1988) at 21. For a discussion of these provisions, in conjunction with their parallels in the Hammurabi Code as set out in the note which follows, as well as in the Bible, see Yaron, *ibid* at 248–51.

<sup>29</sup> Sections 120–121 governed the storage of grain while ss 122–126 dealt with the safekeeping of silver, gold or anything else. Liability for storage (under s 120) appears to be more stringent than for safekeeping (under s 125). Hammurabi's Code is from the early years of his reign.

<sup>30</sup> Bogaert, *Les Origines*, above n 11 at 59, 84 fn 236, 99 text and nn 311–13.

<sup>31</sup> In stating, however cautiously, that 'no transfers from one account to another are proven with certainty', Bogaert, *ibid* at 126 may be read as not excluding altogether this possibility. At 99 he is however quite definitive as to denying that possibility for the Hammurabi's era (1792–1750 BCE), particularly in light of the depositary's liability under s 120 of the Hammurabi Code to pay the depositor double the amount of any lost stored grain. Such liability is inconsistent with co-mingling or mixing, since in the absence of segregation, in the case of a loss of a part of the grain stored in the granary, it would be impossible to ascertain which grain was stolen so as to establish to whom double is owed among the various depositors.

A debtor or lender, acting as a payer, could issue a payment order instructing payment to be made to the payee, respectively being his creditor or borrower. Payment orders of all types were in writing, but could also be oral. Whether issued orally or in writing (namely inscribed on a tablet), a payment order directed payment to be made either to a payee known to the order receiver or to a payee to be properly identified.<sup>32</sup> Possibly then, it was the order receiver who then advised the payee of the payment order so that a communication from the payer to the payee was not part of the mechanism.

Thus, throughout the ninth and eighth centuries BCE, merchants in Babylonia and Chaldea paid by instruments 'very like bills of exchange',<sup>33</sup> inscribed on clay bricks. These instruments were drawn by one person on another for a sum expressed in weights of silver or copper. They were used as a means of reducing the transport of silver or copper in the landborne trade, where the caravans 'passed over routes infested by robbers.'<sup>34</sup> These early bills of exchange were used to avoid the problem of bulk, as well as the need to weigh and test the quality of precious metals tendered in payment.

A depositary to whom a payment order was issued may have been a granary or warehouse, with whom the payer held a deposit account; it could also be an intermediary with whom the payer deposited the sum of payment for specific transmission to the payee.<sup>35</sup> However, the payment order might be addressed by the payer not only to a depositary, but also to the payer's debtor under an earlier unrelated transaction. Stated otherwise, a non-depositary debtor could also be an order receiver and effectively act as a paymaster complying with the order. In such a case payment to the payee was in the owed fungible item; typically it was barley; alternatively, other than in the case of payment by a granary, it could also be silver.<sup>36</sup>

The legal effect of the order may have been determined under the law that governed the assignment of debts. In principle, the assignment or transfer of debts was recognized; thus, there is evidence to the transferability of notes of indebtedness, or 'promissory notes' from the hands of one creditor to those another,<sup>37</sup> albeit in a procedure whose practice and legal underpinning are not entirely clear.

<sup>32</sup> Bogaert, *Les Origines*, above n 11 at 99. For written orders issued by a lender temple directed to a warehouse or granary at the locality of the payee-borrower see Bogaert, *ibid* at 54. An order to a non-depositary obligor could be either written or oral. *Ibid* at 100.

<sup>33</sup> AR Burns, *Money and Monetary Policy in Early Times* (New York: AM Kelley, 1965, reprint 1927) at 284.

<sup>34</sup> *Ibid* at 285. See also Einzig, above n 19 at 206–07.

<sup>35</sup> The latter mechanism was useful for a debtor in case of lack of time to make payment in person, absence of business experience, or temporary absence from the city at the time payment was due. See Bogaert, *Les Origines*, above n 11 at 116–17.

<sup>36</sup> Bogaert, *Les Origines*, *ibid* at 100.

<sup>37</sup> With regard to Old Babylonia, see eg M Van de Mieroop, *Society and Enterprise in Old Babylonian Ur* (Berlin: Dietrich Reimer Verlag, 1992) at 207 and M Van de Mieroop, 'Credit as a Facilitator of Exchange in Old Babylonian Mesopotamia' in M Hudson and M Van de Mieroop (eds), *Debt and Economic Renewal in the Ancient Near East* (Bethesda, Md.: CDL, 2002) at 163, 166 (hereafter: Van de Mieroop, 'Credit as a Facilitator').

In our setting, the assignment would have been by the payer to the payee of the debt owed to the payer (order giver) by his debtor (order receiver).<sup>38</sup> In this setting, the payer (order giver) was the assignor, the payee was the assignee, and the payer's debtor (order receiver) was the obligor. An assignment could have been effectuated by (i) a new acknowledgement of the debt made by the obligor (in our case the payer's debtor); (ii) the surrender by the assignor (the payer-order giver) to the assignee (payee), of the obligor (payer's debtor)'s original acknowledgement of debt (owed by the obligor to the payer); or (iii) the sale of the debt by the assignor (payer/order giver) to the assignee.<sup>39</sup>

And yet, other than in the first case, that of a renewed acknowledgement made by the assignor (payer), directed to the assignee (payee), the issue of consent by the paymaster/obligor (payer's debtor) could not have been bypassed. An obligor who had not originally agreed with his creditor (the payer in our setting) to the possibility of assignment, was under no obligation to carry out the order.

The obligor's consent to a future assignment could have been given in advance, as part of his obligation to his creditor. Consent could possibly be in the form of an acknowledgement of the original debt as payable 'to the bearer'.<sup>40</sup> While it is contested whether a debt payable to the bearer was transferable,<sup>41</sup> it is agreed that the obligor was bound by his obligation (or acknowledgement of an obligation) to pay to the bearer. Stated otherwise, an obligor could not lawfully resist a demand for payment made by whoever presented to him the document containing the bearer clause.<sup>42</sup> In practice, a payer-debtor owed by an obligor under an undertaking containing a bearer clause, would get a discharge from his creditor, the payee, against the physical delivery to the payee-creditor of the document (or tablet) containing the payer-debtor's obligor undertaking to pay to the bearer; this would leave the payee-creditor with an enforceable claim against the payer's obligor under the promise to pay to the bearer.<sup>43</sup> Thus, even if a debt payable to the bearer could not be assigned, it was not within the power

<sup>38</sup> While each deposit may have been physically segregated, inasmuch as a depositary's obligation was in relation to fungible items, it could roughly be characterized as a 'debt'.

<sup>39</sup> These three methods of assignment are set out by Bogaert, *Les Origines*, above n 11 at 123–24. In modern terminology the first method is however novation rather than assignment. The distinction is highlighted in ch 5, particularly in sections 6.2, 9 and 11 below.

<sup>40</sup> Bogaert, *Les Origines*, *ibid* at 100. For the use of such clauses in obligations payable to temple authorities, palace authorities, and individuals see Bogaert, *Les Origines*, *ibid* at 55, 66, 73–74, and 102. See also Van de Mieroop, 'Credit as a Facilitator' above n 37 at 166. Tablets containing such a clause are compiled by AH Pruessner, 'The Earliest Traces of Negotiable Instruments' (1928), 44:2 *The American Journal of Semitic Languages and Literatures* 88, who further attests to the compliance of the instruments he examined with other formal requirements of negotiability under modern law, such as signature, unconditional promise or order, and certainty as to the time the instrument is payable.

<sup>41</sup> And yet while the instrument embodying it was certainly not fully negotiable (see Bogaert, *Les Origines*, *ibid* at 95), it already contained important elements of this quality. Cf Bogaert, *Les Origines*, *ibid* at 129.

<sup>42</sup> Bogaert, *Les Origines*, *ibid* at 55, and 94–96. Arguably, however, in the absence of full negotiability (*ibid*), this is so at least as long as the presenter had lawful possession of the document.

<sup>43</sup> Bogaert, *Les Origines*, *ibid* at 100.

of the obligor to object to a demand presented to him by the payee, being a person designated by the obligor's own creditor, the payer, to receive payment.<sup>44</sup>

In any event, regardless of the form of his debt acknowledgement, the issue of the obligor's consent may have been limited to the case of a non-depositary obligor; it may not have arisen in connection with a depositary. This was so whether the depositary was a granary, warehouse, or intermediary with whom the payer deposited the amount of payment to be transmitted to the payee; in taking a deposit, either for a specific purpose or under a deposit account, a depositary must have been taken to consent to the assignment.

As indicated, there appears to be no evidence for the execution of non-cash payments from one account to another. However, we do see the provision of nascent payment services in Ancient Mesopotamia in the form of third-party withdrawals in specie or kind, particularly from a depositor's account, carried out by depositaries in pursuant to the depositor's instructions. And yet, while both deposit taking and lending<sup>45</sup> were carried out by the same entities, lending was not made out of deposits<sup>46</sup> so that, in the final analysis, no 'banking' could be said to exist in Ancient Mesopotamia.

### 3. ANCIENT GREECE

If Ancient Mesopotamia was the 'cradle of banking operations', the emergence of the bank as a distinct type of institution carrying out 'banking', namely financial intermediation between depositors of funds and borrowers of those funds,<sup>47</sup> took place in Ancient Greece.<sup>48</sup> More specifically, the process took place in the Mediterranean territory on which Ancient Greek civilization expanded,<sup>49</sup> almost throughout the entire classical period of that civilization.<sup>50</sup>

<sup>44</sup> Bogaert argues that the original purpose of a bearer clause was to facilitate collection by a representative of temple or palace authorities to whom the obligor incurs his debt. Bogaert, *Les Origines*, *ibid* at 55 and 127–28.

<sup>45</sup> For the lending activities of temples, see Bogaert, *Les Origines*, *ibid* at 66, of palaces *ibid* at 76, and of individuals *ibid* at 108 and 119.

<sup>46</sup> Bogaert, *Les Origines*, *ibid* at 126–29.

<sup>47</sup> But cf WL Westermann, 'Warehousing and Trapezite Banking in Antiquity' (1951), 3 *Journal of Economic and Business History* 30 at 31 who highlights 'a sound contrast between the relatively simple services rendered by the bank and the banker in antiquity . . . and the commanding position and complex character of banking as a function of credit in the economic system of today.' No doubt, such a contrast really exists, and yet it is not on point in tracing the roots of the modern bank to its predecessor in Ancient Greece.

<sup>48</sup> The ensuing discussion draws on R Bogaert, *Banques et Banquiers dans les Cités Grecques* (Leyde: AW Sijthoff, 1968) at 50–60 and 331–45 (hereafter: Bogaert, *Banques et Banquiers*); Bogaert, *Les Origines*, above n 11 at 130–58; EE Cohen, *Athean Economy and Society: A Banking Perspective* (Princeton NJ: Princeton University Press, 1992) at 8–11, 14–18, 62–66 and 111–21.

<sup>49</sup> Roughly speaking this territory covers mainland Greece, Greek Islands (together roughly coinciding with the area of modern-day Greece), and the western coast of Asia Minor or Anatolia (the latter of which is part of modern-day Turkey).

<sup>50</sup> The Classical Period is said to have lasted between 500 and 336 BCE. It was preceded by the Archaic Period (stretching from 750 to 500 BCE) and followed by the Hellenistic Period (taking

Deposit taking and lending were carried out in Ancient Greece by temples. And yet, such operations constituted a secondary and occasional activity for them; moreover, temples lent out of their capital (namely, consecrated funds given to them mainly by donation) rather than out of deposits, and had not acted on payment orders instructing payment to creditors of their depositors. In short, banking operations by temples fell short of banking operated by banks.<sup>51</sup>

Rather, the early true bankers in Greece were the moneychangers. As a profession or calling, money changing surfaced in the sixth century BCE, shortly after the appearance of coined money as a medium of exchange in commercial transactions.<sup>52</sup> Unlike 'banking services' in Ancient Mesopotamia, 'banking', and with it 'banking services', emerged in Ancient Greece in the wake of the birth of coined money.

Conditions prevailing in the currency system of the ancient world, and to a varying degree, during the entire pre-modern era, provide the explanation for the role of the moneychanger in his contemporary economy. To summarize,<sup>53</sup> pre-modern era currency consisted of coins whose value primarily depended on their intrinsic value. Smooth flow of good quality small change was hampered by the high cost of production (relative to intrinsic value), which led to an enduring problem of recurring scarcity and depreciation of it.<sup>54</sup> Furthermore, an assured mechanism for the supply of small change, as well as for the replacement of damaged or eroded currency, available free of charge, did not exist. Against this background, money changing had been provided for a fee not only for the exchange of currencies of different issuers, as in the present day; but also for the exchange of different denominations, as well as of varied metals and qualities, of the currency of the same issuer.<sup>55</sup> In this environment, a market for exchanging coins of different issuers, denominations and qualities had emerged, with moneychangers being its principal actors. In carrying out their principal function of money changing, moneychangers had acquired expertise as assayers

place between 336 and 146 BCE). The latter commences with Alexander the Great (336–323 BCE) under whose reign Greek civilization extended eastwards where it met and mingled with Eastern civilization. For time periods in the history of Ancient Greece you may visit [www.en.wikipedia.org/wiki/Timeline\\_of\\_ancient\\_Greece](http://www.en.wikipedia.org/wiki/Timeline_of_ancient_Greece). Banking in the Hellenistic Period is discussed in section 5 below.

<sup>51</sup> For the operation of temple banks in Ancient Greece see Bogaert, *Banques et Banquiers*, above n 48 at 279–304.

<sup>52</sup> For the emergence of money as a medium of exchange in commercial transactions see ch 2, section 1.2 above.

<sup>53</sup> See above, ch 2, particularly sections 1.2 and 2.

<sup>54</sup> Briefly stated, and using modern currency, in ancient times, one dollar cost less than four quarters. For an extensive discussion throughout the centuries, see: TJ Sargent and FR Velde, *The Big Problem of Small Change* (Princeton and Oxford: Princeton University Press, 2002).

<sup>55</sup> For this practice in the Ancient World see J Andreau, *Banking and Business in the Roman World*, trans by J Lloyd (Cambridge: Cambridge University Press, 1999) at 37 (hereafter: Andreau, *Banking*). The practice is also confirmed by the Jewish Talmud, in Talmud, *Bava Metzia* at 46A. A comprehensive exposition of the moneychanger's business, who primarily changed money for a fee from one coin or denomination to another, including in another metal, is by A Gulak, 'The Moneychanger's Business According to Talmudic Law' (1931), 2 *Tarbitz* 154 [in Hebrew].



of coin, who verify and attest as to its being genuine (and not counterfeit) and of good quality.<sup>56</sup> They further became experts in handling and storing money.<sup>57</sup>

The origin of money changing is in Ancient Greece. A moneychanger in Ancient Greece was called a *trapezites* (in plural, *trapezitai*), and his business was a *trapeza* (in plural *trapezai*), after the table on which money was handled by him in the marketplace. In the course of the fifth century BCE, in a process that may have been completed at the beginning of the fourth century BCE, the *trapezites* had come to take funds from the public on deposit and use them to make loans on his own account, thereby becoming a banker in the modern sense of the word. In the process, the Greeks became ‘the creators of the bank of deposit.’<sup>58</sup>

Over the years, competition to the *trapeza* as a private bank came from public banks. Public banks were either (i) franchised monopolies, owned and operated by individuals for their profit,<sup>59</sup> or (ii) banks owned and run by the state for public interest. The main occupation of the former was money changing. The latter, known as *demosiai trapezai*, may also have changed money, and they certainly accepted deposits, made loans, and received payments and carried out payment orders. Effectively, each *demosia trapeza* was a department of the public treasurer in charge of all banking operations that the financial management of the city necessitated. The orthodox view has been that all banking functions were carried out exclusively on behalf of and for public authorities and bodies, including charitable foundations.<sup>60</sup> This view has been challenged; it is argued now that their role in accepting private deposits and using such funds for public lending has been underestimated.<sup>61</sup> At the same time, the developments set out below are primarily associated with the *trapeza*, the moneychanger turned private banker; the public bank will be revisited in the discussion further below in section 5, dealing with Egypt.

The process of the transformation of the moneychanger into a private banker may have taken place gradually. In the first stage, merchants tended to make payments in the presence of a moneychanger, who would attest to the quality of the coin, its being genuine, as well as to the occurrence of actual payment. In connection with each prospective payment it then became common to deposit money with the moneychanger in advance. Payment would then be carried out by the moneychanger in the presence of the payer and the payee. Next, it became usual for merchants to deposit money with a moneychanger for several future

<sup>56</sup> See in general, R Bogaert, ‘L’Essai des Monnaies dans l’Antiquité’ (1976), 122 *Revue Belge de Numismatique et de Sigillographie* 5.

<sup>57</sup> See in general, Bogaert, *Banques et Banquiers*, above n 48 at 308–31.

<sup>58</sup> *Ibid* at 413.

<sup>59</sup> Certainly, a predefined amount or share out of the profit went to the franchisor, namely, the public authority that granted the franchise-monopoly; a franchise was not given against a mere licence fee.

<sup>60</sup> See Bogaert, *Banques et Banquiers*, above n 48 at 402–08.

<sup>61</sup> V Gabrielsen, ‘The Public Banks of Hellenistic Cities’ in Verboven et al, *Ancient World*, above n 12 at 115.



anticipated payments. Each payment would then be carried out by the money-changer as instructed by the depositor, without the need for the depositor to appear in person for its actual execution. To accommodate safekeeping of money for prospective payments, moneychangers came to possess facilities that would enhance the security for deposited money and protect it against risks such as theft or fire. Obviously, this led to enhanced confidence in their services. Together with the enhancement of their reputation for competence and honesty, this attracted more deposits, which may also have been made as a means to effectively hide private wealth.<sup>62</sup> Moneychangers quickly realized that they had at their disposal more money than they needed to meet withdrawal or payment demands of their depositors and commenced lending 'surplus' money for profit.<sup>63</sup> Thus, deposit taking, executing payment orders out of deposits, and lending out of deposits were combined into 'banking' in the full sense of the word.

A deposit of money received from a member of the public was treated by the *trapezites* as a loan made to him by the depositor, to be returned in equal amount rather than in the specific coins originally 'deposited'. Money deposited by one person was mixed by the *trapeza* with money deposited by others, and mingled by the *trapezites* with his own money;<sup>64</sup> in the process, the *trapezites* himself was held personally liable to the depositor for the repayment of the amount of the deposit. At the same time, having borrowed and thus acquired the money 'deposited', the *trapezites* could lend out of it to third parties for his own profit (albeit at his own risk).

The *trapezitai* offered a broad range of services, from assistance in drawing documents and their safekeeping to the performance of various forms of financial accommodation.<sup>65</sup> There may be no consensus as to the scope of credit operations carried out by them as well as on the quantitative impact of money lent by them on the economy.<sup>66</sup> However, their contribution to economic integration of various segments of society was pointed out.<sup>67</sup> Moreover, it seems to be agreed that in lending out of deposited money, which nevertheless remained

<sup>62</sup> Money deposited with a banker was 'visible' only as long as it was 'openly drawn upon as ready cash for current needs.' See JW Jones, *The Law and Legal Theory of the Greeks: An Introduction* (Oxford: Clarendon Press, 1956) at 210. The point is however contested by R Bogaert in a book review (on Cohen's book, above n 48), 'Cohen, Athenian Economy and Society' (1995), 67(7) *Gnomon* 604 at 607 [in French], where the public nature of the banker's books is pointed out.

<sup>63</sup> Scope and contents of credit operation is however strongly contested. Contrast Bogaert's 'minimalist' approach in *Banques et Banquiers* above n 48 at 411–12, with the extensive discussion by Cohen, above n 48 at 190–224.

<sup>64</sup> Bogaert, *Banques et Banquiers* above n 48 at 333 treats such a deposit as 'irregular' in the sense subsequently given to it by the Romans (as discussed in ch 5, section 2 below). In the view of Cohen, above n 48 at 112–13 this is however an anachronism.

<sup>65</sup> See eg J Toutain, *The Economic Life of the Ancient World* (New York: Barnes & Noble, 1968, first published in the UK, 1927) at 75–76.

<sup>66</sup> Bogaert, *Banques et Banquiers* above n 48 at 367. Bogaert himself, *ibid* at 411–12, is more cautious and tentative than eg Cohen, above n 48 at 190–224.

<sup>67</sup> Eg, K Shipton, 'Bankers as Money Lenders: the Banks of Classical Athens' in Verboven et al, *Ancient World* above n 12 at 93, concludes at 113 that in contrast to private lenders, '[t]he banks . . . tend[ed] to integrate the cash-based economy, linking citizen with non-citizen and wealthy elite with humble trader through their re-circulation of cash in a constant cycle of deposits and loans.'

available for the use of the depositors, the *trapezitai* stimulated monetary circulation and expanded economic activity.<sup>68</sup> For our purposes, it is important to add that in broadening their deposit base with the view of expanding their capacity to lend, *trapezitai* provided the infrastructure facilitating payments out of and into such deposits.

A deposit payable on demand (or 'payment deposit') could be made to a *trapeza* either for safekeeping, in general, not with the view of any specific forthcoming payment, or on an ad hoc basis, for a specific forthcoming payment.<sup>69</sup> When the former exists, we can treat the depositor as a customer. A *trapeza* effectively kept a running account for each customer, posting to it each deposit and withdrawal.<sup>70</sup> A withdrawal from a customer's account could be made for the entire or part of a balance due on deposited money, either by the depositor himself, or by a designated payee (or on his behalf), namely, a third person, in pursuance to the depositor's instruction. In connection with an ad hoc deposit made for a specific payment, withdrawal was usually made by the payee or on his behalf, in the amount of the deposit.

Either way, a withdrawal required a payment order to be given by the depositor to the *trapeza*. A payment order was usually given to the *trapeza* orally and in person;<sup>71</sup> written instructions were rare, and primarily served a depositor who was either an official or who happened to be located away from the place of his *trapeza*. A written communication could also be a mere confirmation of an earlier effective oral order. Each payment order specified the amount to be paid. In connection with withdrawals to be made by a third-party payee, the payment order further identified the payee or a person who would identify him.<sup>72</sup> In the case of a non-customer or where no adequate balance was available, the payment order may have been accompanied by the deposit of actual coins. As may be required, in each case, the *trapezites* recorded on his books information relating to the depositor's name, sum deposited, the name of the payee, the name of the person who will introduce the payee, and the date when payment is to be made.<sup>73</sup>

Where the depositor (namely the payer) and payee held accounts with the same *trapeza*, it was possible to carry out a non-cash payment by simply debit-

<sup>68</sup> Bogaert, *Banques et Banquiers* above n 48 at 374.

<sup>69</sup> Bogaert, *Banques et Banquiers*, *ibid* at 331–51 distinguishes between such deposits, which did not bear interest, and interest-bearing investment (or time) deposits. In his view, eg *ibid* at 360, interest liability on investment deposits precluded Greek bankers from lending at a reasonable rate. Both the existence of interest-bearing time deposits in Ancient Greece, and the alleged resulting unavailability of reasonable priced bank credit are contested by WE Thompson, 'A View of Athenian Banking' (1979), 36 *Museum Helveticum* 224.

<sup>70</sup> On the evolution of accounting in Greece see eg L Migeotte, 'La comptabilité publique dans les cités Grecques: l'exemple de Délos' in Verboven et al, *Ancient World*, above n 12 at 59, and V Chankowski, 'Banquiers, Caissiers, Comptables. À Propos des Méthodes Financières dans les Comptes de Délos' in Verboven et al, *Ancient World*, *ibid* at 77.

<sup>71</sup> Which did not preclude the issue of a payment order by a slave on behalf of his master where the slave was known to the banker.

<sup>72</sup> Identification could be facilitated by introducing the persons to be identified (ie either the payee or persons to identify the payee), in person, to the *trapeza* ahead of time.

<sup>73</sup> Westermann, above n 47 at 40.

ing the depositor's account and crediting that of the payee on the books of the *trapeza*.<sup>74</sup> Arguably, with the view of accommodating such a procedure, it was quite common for people making ongoing payments to each other, as for example when they were involved in the same trade, to keep their accounts with the same *trapeza*. For a payee not holding an account with the *trapeza* in which payment was deposited, a more complex procedure was required.

Thus, for each payment to a designated payee, having received the payment order and being in possession of cover, the *trapezites* sent a note to the payee, known as a *diagraphé*, advising him of the funds available at the payee's disposal.<sup>75</sup> In the process, having made an appropriate entry in his books in the payee's favour, the *trapezites* became accountable to the payee. To that end, 'as long as [the banker] himself was not prejudiced in any way it was no concern of his whether the payee had given value to the depositor'.<sup>76</sup> Indeed, written abstract contracts, making a debtor liable to the creditor for a specified sum of money owed, irrespective of the cause of the debt, and hence of any defence that may have been asserted by the debtor on the basis of the cause, have been known to the Ancient Greeks;<sup>77</sup> thus the 'quasi abstract' liability of *trapezitai* for the mere sum of money appears to be quite consistent with contemporary jurisprudence.<sup>78</sup>

<sup>74</sup> Bogaert, *Banques et Banquiers*, above n 48 at 342–44 is sceptical as to the scope and even the existence of such a practice in Ancient Greece. However, Cohen, above n 48 at 18 does not appear to share this scepticism.

<sup>75</sup> Terminology could however be confusing. According to Bogaert, *Banques et Banquiers*, above n 48 at 57–59, *diagraphé* could also refer to the payment order. Cohen, *ibid* states at 17 that *diagraphé* also denoted 'the cashless settlement of debts through bank entries.' All such meanings, in addition to others outside banking, are confirmed by H Cancik and H Schneider (eds), *Brill's New Pauly Encyclopaedia of the Ancient World: Antiquity* (Leiden-Boston: Brill, 2004) vol 4 at 345 (v. 'Diagraphhein, diagraphé') where it is stated that between the third century BCE to the late first century CE, the term refers 'both to the payment procedure itself as well as to the entry in the bank register and the bank's certificate confirming the transaction conducted, be it a cash payment [or] a transfer between accounts.' Bogaert, *Banques et Banquiers*, *ibid* at 37–60 has an extensive discussion on Greek banking terminology, albeit without transliterating terms or even providing an alphabetical glossary, which unfortunately hampers accessibility.

<sup>76</sup> See Jones, above n 62 at 220–21.

<sup>77</sup> Gaius, who according to A Berger, *Encyclopedic Dictionary of Roman Law* (Philadelphia: American Philosophical Society, 1953) at 481, is '[o]ne of the most renowned Roman jurists of the middle of the 2nd century [CE] (born after Hadrian),' refers to 'an obligation by writing [that] appears to arise through the documents called in Greek "chirographs" and "syngraphs".' See *The Institutes of Gaius*, Book III §134. See eg translation by WM Gordon and OF Robinson, *The Institutes of Gaius* (Ithaca: Cornell University Press, 1988) at 341. See also F De Zulueta, *The Institutes of Gaius*, Part I: Text with Critical Notes and Translation (Oxford: Clarendon Press, 1946) at 195 where reference is made to a 'literal obligation [that] appears to be created by' such documents. In Part II: Commentary (Oxford: Clarendon Press, 1953) at 166, De Zulueta explains that while the *chirograph* was a letter written by the debtor addressed to the creditor, the *syngraph* was a witnessed document sealed by both parties and deposited with an official. He further asserts (*ibid*) that according to the modern view, 'documents in either form could be abstract contracts, though purporting to be evidence of a debt from some (fictitious) *causa*, the commonest fiction being that of a loan'. Cf Jones, *ibid* at 220–22. For more sources and subsequent developments, see below ch 5, section 8.

<sup>78</sup> And yet I am not arguing that the advice note was formally a *chirograph*, and certainly it could not be a *syngraph*, as both are described *ibid*. I am not even suggesting that the *diagraphé* was fully abstract; certainly, there is nothing in Jones's statement in the text at n 76 above, to preclude the

Three scenarios could then develop:

- (i) First, in the most usual case, the payee could come in person to the *trapeza*, properly identifying himself, and obtain payment in cash over the counter.
- (ii) Alternatively, certainly where the advice note issued by the *trapeza* was made out to the payee 'or order', the payee could appoint an agent, usually another *trapeza*, to come to the payer's *trapeza*, where money was deposited, and claim on the payee's behalf payment in cash over the counter.
- (iii) Finally, in the further alternative, the payee's *trapeza* may have been prepared to credit the payee's account in advance. This could possibly happen on the basis of the advice note issued to the payee by the payer's *trapeza* and presented to the payee's *trapeza* by the payee, and in anticipation of subsequent payment by the payer's *trapeza*. Payment by payer's *trapeza* to the payee's *trapeza* could be effectuated either in coins, or as part of either bilateral or multilateral setoff; and yet, neither an intra-city nor an inter-city interbank clearing system, whether bilateral or multilateral, existed in Ancient Greece.<sup>79</sup>

Certainly a payee-creditor would be expecting payment to be forthcoming; possibly, in any given case, the method of payment, and even the identity of the payer's *trapeza* involved in the process, might have been agreed by, or at least advised to, the payee in advance. However, the process did not contemplate any written note or other communication issued by the payer to the payee, authorizing the latter to collect the funds, such as the modern cheque.<sup>80</sup> Furthermore, the advice note issued by the payer's *trapeza* to the payee was not transferable, even when it was made out payable 'to order'.<sup>81</sup> In each of the three scenarios set out above, the payer's *trapezites* would release the funds, to the payee or his *trapeza*, against the presentation and surrender of the advice note (*diagraphé*) which the payer's *trapezites* had sent the payee. An advice note, or a separate receipt, signed by the payee (or on his behalf) acknowledging payment, surrendered to the payer's *trapeza*, might have been sent by him to the payer, and would serve as a receipt of completed payment. The acknowledging payment, whether or not stated on the *diagraphé*, was called *hypographé*.<sup>82</sup>

*trapezites* from asserting towards the payee the *trapezites'* own defences (if any) against the payer that would have prevented the advice note from being a complete abstract contract.

<sup>79</sup> Bogaert, *Banques et Banquiers*, above n 48 at 344–45 and 413.

<sup>80</sup> Bogaert, *Banques et Banquiers*, above n 48 at 340–41 highlights this fact, and traces the origins of the cheque to the Jewish Talmud, a point contested in ch 4 below. The view to the contrary, that traces the cheque and even the bill of exchange to Ancient Greece, as eg in E Guillard, *Les Banquiers Athéniens et Romains suivis du Pacte de Constitut en Droit Romain* (Paris, Lyon: Guillaumin, H. Georg, 1875) at 9, has not been endorsed and appears to be outdated.

<sup>81</sup> For the 'modest' implication of such a clause, as limited to conferring power on an agent rather than title on a transferee, see in general, Jones, above n 62 at 223–24.

<sup>82</sup> But see Bogaert, *History*, above n 3 at 28, where (contrary to Bogaert, *Banques et Banquiers*, above n 48 at 58) it is stated that it is the *payer's banker* (and not the payee) who signs and retains the *hypographé*.

An analysis of the entire process points out an ambiguity as to the point of time at which the payer-debtor became discharged to the payee-creditor. The use of the *hypographé* as a proof of payment in the payer's hands, may suggest that the payer did not get his discharge until actual payment by the *trapezites* to the payee. And yet, as just indicated above, the *trapezites* became accountable to the payee as of making the appropriate book entry and sending him the *diagraphé*, which may suggest that as of that time he has substituted the payer as the debtor owing money to the payee. Alternatively, the payer-debtor may have been only conditionally discharged upon the *trapezites* becoming accountable to the payee and may have obtained his absolute discharge upon full payment. Or, as further alternatives, between the time the *trapezites* became accountable to the payee and the time the *trapezites* made actual payment to the payee, both the *trapezites* and the payer are either co-debtors, or one guarantees the debt of the other to the payee. All such options appear plausible.<sup>83</sup>

In any event, payment through a bank was beneficial to all parties. The payer gained from a process that produced an iron-clad evidence of payment recorded in bank books, as well as on the *hypographé* that he may have received, so that 'he did not need to round up people to witness the repayment.'<sup>84</sup> For his part, the payee benefited from the availability of the funds at the payer's *trapeza* to his own credit as of the issue of the advice note. Finally, the payer's *trapezites* took advantage of the fact that the process of completing the payment, from the deposit of funds, until the actual withdrawal of funds by the payee or on his behalf, was slow; in connection with an anticipated payment it was not uncommon for a payer to deposit funds with a *trapezites* prior to incurring the actual payment obligation, and instruct payment to be made to the payee only upon reaching an agreement with him and incurring payment liability. In practice, during the gap, funds were available for the use of the payer's *trapeza*. This served as an economic incentive for *trapezai* to be involved in handling payment orders. More generally, it is the availability to the *trapezites* for his own use of deposited funds which facilitated both the deposit taking and the provision of payment services by the *trapezites* typically at no charge.

There are indications that *trapezai* were involved in intercity payments. Thus, in anticipation of travel to another location, and with the view of avoiding the risk of physical transportation of money, a deposit made by the prospective traveller in the city of origin, could be withdrawn by the depositor in the city of destination. Withdrawal in the destination city would be made by the depositor from a correspondent of the *trapeza* of deposit. As well, a lender who was about to travel and who anticipated repayment of the loan to be made by the correspondent or relative of the borrower at the destination city, might rely on a

<sup>83</sup> While the *trapezites* was selected by the payer, payment through him was agreed by the payee so that the payee might have been taken to agree to substitution, namely, to the absolute discharge of the payer upon the *trapezites* becoming liable to him. This lends support to the option of absolute discharge but certainly does not eliminate others.

<sup>84</sup> Thompson, above n 69 at 238.

*trapeza* at the place of origin to guarantee him repayment upon return from the travel; such a guarantee would be called on by the lender if the borrower's correspondent in the place of destination did not honour the instruction of the borrower.<sup>85</sup> However, there appears to be no indication of commercial payments between a debtor and creditor, eg a buyer and seller, or even a borrower and lender such as 'on the security of a ship or cargo' in different cities.<sup>86</sup> As already mentioned, neither intra-city nor intercity interbank, whether bilateral or multilateral, clearing systems, existed in Ancient Greece.<sup>87</sup>

#### 4. ANCIENT ROME

Between around 500 BCE and 30 CE the Roman Republic grew from a city state to dominate first Italy, then the Western Mediterranean and, finally, the entire Mediterranean basin. In the process, Rome had undergone a fundamental change in its system of government and came to be the Roman Empire. The City of Rome ultimately fell at 476 CE, an event which marks the end of the Roman period in the West.<sup>88</sup>

Certainly, as the Roman Empire grew to the East, contact intensified with banking institutions and practices that followed the conquests of Alexander the Great (336–323 BCE). Those institutions and practices had already flourished as a result of the interaction between the Ancient Greek and the Ancient Eastern civilizations. The present section will however deal with institutions and practices that were germane to the Romans in the West, namely, the Latin speaking part of the Empire. Mechanisms, practices and institutions that developed in Greco-Roman Egypt, situated in the Roman East, namely the Hellenized or predominant Greek speaking part of the Empire, are left to a separate discussion that will follow in section 5 below.

<sup>85</sup> Westermann, above n 47 at 41. See also Bogaert, *Banques et Banquiers*, above n 48 at 344, fn 228 and Jones, *ibid* at 225. In the latter case, the borrower and lender resided in the city of origin of the lender's anticipated travel. The borrower wished money he had in the lender's destination city to be brought to him to the city of origin. The lender had money in the city of origin but intended to use same amount in the destination city. If everything went as planned, the borrower would have the lender's money in the place of origin and the lender would have received the borrower's money in the city of destination for the lender's commercial use in the destination city; this way no money was to be physically transported by the traveller (ie the lender) in either direction of the trip with each party having the use of the money in the desired place.

<sup>86</sup> Jones, *ibid* at 225. Westermann's statement, *ibid* at 41 that out of the situation described in the preceding footnote 'arose . . . a sea loan' seems doubtful. Maritime loans are extensively discussed by Cohen, above n 48 at 121–89; yet his view, and particularly on bankers' role in making such loans is contested by Bogaert in a book review, above n 62.

<sup>87</sup> See above, text and n 79.

<sup>88</sup> An outline of Roman history can be found, eg, at [www.historyforkids.org/learn/romans/history/history.htm](http://www.historyforkids.org/learn/romans/history/history.htm). In 320 CE Emperor Constantine chose Byzantium (present-day Istanbul) as the new capital of the Empire and renamed it Constantinopolis. He officially divided the Empire into an Eastern and Western Empire in 395 CE. The Eastern Empire survived for close to 1,000 years after the fall of Rome, until Constantinopolis fell to the hands of the Ottoman Turks in 1453 CE, except that particularly as of the rise of Islam at the seventh century CE it had been considerably weakened long before its ultimate fall.

Rome developed its own banking institutions and practices, benefiting from, and assimilating, what it had received from Greece. At the same time, as outlined in section 3 above, while the invention of coined money led to the transformation of the moneychanger in Ancient Greece into a deposit banker, coinage in Rome may not have contributed to the development of banking.<sup>89</sup> Certainly, a uniform system of Imperial coins<sup>90</sup> curtailed the evolution of foreign exchange.<sup>91</sup> Furthermore, the emergence of a sophisticated and reliable coin system favoured payment in cash thereby arresting an accelerated development of banking in general and a non-cash payment system in particular. This is due not only to technical improvements in the production of coins which enhanced the reliability of their use. Rather, this is also attributed to the employment of images and inscriptions engraved on a circulating coin. These images and inscriptions were designed to express the divinity of the reigning ruler and his sovereign power,<sup>92</sup> and their circulation functioned as a tool for the dissemination of information and propaganda throughout the Empire.<sup>93</sup>

Having served an Imperial interest, the increased circulation of coins in the form of cash payments inevitably competed with the orderly evolution of non-cash mechanisms. At the same time, with the expansion of trade and economic activity in which different parts of the Empire interacted, an increased need for banking was bound to be met. To that end, both extensive financial intermediation<sup>94</sup> and an improvement of methods of payments<sup>95</sup> were noted. According to one assessment, in the final analysis, commercial dealings between distant places 'were . . . settled less by payments in hard cash than by banking operations.'<sup>96</sup>

Roman temples took deposits, but 'contrary to the general practice in the other economies' in Antiquity, they 'did not lend any money at all',<sup>97</sup> not even out of their capital. Presumably, they took deposits strictly for safekeeping and

<sup>89</sup> See in general, Davies, above n 15 at 87–93.

<sup>90</sup> Literature on Roman coinage, during the Empire and before, is voluminous. For a succinct review see eg C Egleton and J Williams, *Money: A History*, 2nd edn (London: British Museum Press, 2007) at 39–61.

<sup>91</sup> 'A unified Mediterranean clearly gave rise to a fewer foreign exchange operations.' See Andreau, *Banking*, above n 55 at 37.

<sup>92</sup> Burns, above n 33 at 133–35.

<sup>93</sup> See eg JMC Toynbee, *Roman Medallions* (New York: American Numismatic Society, 1944) at 15, as quoted in Toynbee, Abridgement by Somervell, above n 19 at 64 who goes as far as to say that 'Modern methods of disseminating news and modern vehicles of propaganda . . . have their counterpart in the imperial coinage, where . . . novelties and variations in types record the sequence of public events and reflect the aims and ideologies of those who control the state.'

<sup>94</sup> See D Rathbone and P Temin, 'Financial Intermediation in First-Century AD Rome and Eighteenth-Century England' in Verboven et al, *Ancient World*, above n 12 at 371.

<sup>95</sup> E Green, *Banking, An Illustrated History* (New York: Rizzoli, 1989) at 12.

<sup>96</sup> Toutain, above n 65 at 320.

<sup>97</sup> B Bromberg, 'Temple Banking in Rome' (1940), 10 *Economic History Review* 128 at 130. For temple lending in Mesopotamia and Greece see above in this chapter, respectively in section 2, text around n 15 and section 3, text around n 51.



possibly for a fee;<sup>98</sup> in fact, there appears to be no indication that they even facilitated the transmission of funds, that is, depositors' payments from and into such deposits. In short, their activity fell short of what could be characterized as 'banking'.

Rather, early bankers in Rome combined money changing, money assaying, deposit taking, lending, and the transmission of funds initiated by customers' payment orders. Bankers also played a specialized role in facilitating payments and extending credit in auctions. Bankers in Rome belonged to four distinct categories, each specialized in its own domain;<sup>99</sup> however, to a large extent, the categories were not mutually exclusive, but rather, overlapped.<sup>100</sup> Other than in border areas under Byzantine influence or control,<sup>101</sup> banks disappeared from the West after the fourth century CE.<sup>102</sup>

The first category was of the *argentarii*, who in effect were the 'successors' of the Greek *trapezitai*. They installed themselves in the Forum of Rome during the last quarter of the fourth century BCE, possibly directly as moneychangers/bankers.<sup>103</sup> As bankers, they accepted deposits and lent money.<sup>104</sup> In the second half of the second century BCE they started to participate regularly in auction sales, something that had not been done by the Greek *trapezitai*. Following the disappearance of any mention of *argentarii* around 260 CE, the name *argentarii* came back around 330–340 CE to describe silversmiths; and yet, as of the end of the fourth century CE, without abdicating their profession as silversmiths, these new *argentarii* began to accept deposits, and became moneychangers and deposit bankers; however, they did not participate in auctions. They disappeared towards the end of the sixth century CE.<sup>105</sup>

The second type was that of the *nummularii*, who appeared, first in the closing decades of the second century BCE in the sanctuary area of Praeneste, a city

<sup>98</sup> Which nevertheless did not preclude the maintenance of accounts for individual depositors (*cf* Bromberg, *ibid* at 129), and hence the mixing of deposited funds and the creation thereby of 'irregular deposits'. For the irregular deposit in Roman law, see ch 5, section 2 below.

<sup>99</sup> For other categories of financial specialists, see K Verboven, 'Faeneratores, Negotiatores, and Financial Intermediation in the Roman World (late Republic and early Empire)' in Verboven et al, *Ancient World*, above n 12 at 211. (hereafter: Verboven, 'Faeneratores') For classification see eg K Verboven, 'The Sulpicii from Puteoli, *Argentarii* or *Faeneratores*?' in P Defosse (ed), *Hommages à Carl Deroux; III – Histoire et Épigraphie, Droit* (Bruxelles: Éditions Latomus, 2003) at 429.

<sup>100</sup> The ensuing discussion draws on J Andreau, *Banking*, above n 55 at 30–49.

<sup>101</sup> Byzantine is the East part of the Empire, referred to in n 105 below.

<sup>102</sup> Bogaert, *Les Origines*, above n 11 at 163–65.

<sup>103</sup> Ie, 'There is absolutely nothing to suggest that the first *argentarii* were silversmiths', nor that they were necessarily Greek. Andreau, *Banking*, above n 55 at 30.

<sup>104</sup> As such they performed financial intermediation. See P Temin, 'Financial Intermediation in the Early Roman Empire' (2004), 64. *Journal of Economic History* 705. The question of non-deposit related financial services offered by deposit bankers in Ancient Rome is touched upon by Verboven, 'Faeneratores' above n 99 at 228–29.

<sup>105</sup> According to Andreau, *Banking*, above n 55 at 33, 'These *argentarii* are still well attested in the sixth century, in the reign of Justinian, and even at the end of the century, in the works of Gregory the Great.' Emperor Justinian reigned over the Eastern Part of the Empire between 527 and 565 CE. See [www.roman-emperors.org/justinia.htm](http://www.roman-emperors.org/justinia.htm). As set out in ch 5 below, he oversaw the great projects for the compilation and codification of Roman law. Gregory the Great is Pope St. Gregory I, a most notable figure in Ecclesiastical History. See [www.newadvent.org/cathen/06780a.htm](http://www.newadvent.org/cathen/06780a.htm).



situated on a strategic spur of the Apennines, in central Italy, east of Rome. They appeared in Rome in the early years of Augustus' reign, namely some time between 31 BCE and 14 CE. Until the first half of the second century CE, they were coin assayers and moneychangers; subsequently, they followed in the footsteps of the *argentarii* and became banks of deposits; yet they never took part in auctions. They are mentioned up to the beginning of the fourth century CE.

The third group was that of the *coactores*, who were active from around 150 BCE<sup>106</sup> until about the middle of the second century CE. *Coactores* did not take deposits for safekeeping, and thus, strictly speaking, were not bankers. Rather, they 'were basically in charge of accepting, recording, and delivering payments of diverse origin, including proceeds from auctions.'<sup>107</sup> They acted as private receivers, whose role was to make payments out of funds they obtained from their clients for that purpose. They charged fees for their services. Particularly, *coactores* made payments in auctions, out of clients' funds kept with them. In holding funds earmarked for payments, and facilitating payments out of such funds, they performed a banking service, which may explain their treatment together with bankers.

Finally, the fourth profession, that of the *coactores argentarii*, made its appearance possibly during the third quarter of the first century BCE.<sup>108</sup> In effect combining the first and third categories, they were receivers, moneychangers and deposit bankers. No more mention was made of them towards the end of the third century CE.<sup>109</sup> The difference between them and the *argentarii* of the first period, who, approximately between the middle of the second century BCE and the middle of the third century CE, also acted as receivers, was in emphasis; while the *argentarii* were deposit bankers who also acted as receivers, the *coactores argentarii* were receivers who also acted as bankers.<sup>110</sup>

Funds transfers were carried out by Roman bankers as receivers and deposit bankers. Receivers passed money from payers to payees for a commission. Particularly, they acted in auctions. The auction was a common way for selling merchandise in ports and fairs, as well as in wholesale and retail markets. It was also a mechanism for the sale of the estate of a deceased person or an insolvent debtor as well as of goods of a debtor in default. The mechanism was designed to achieve sale to the highest bidder, that is, to secure the sale of goods at the

<sup>106</sup> Or as stated by Andreau, *Banking*, above n 55 at 31 from the time Cato the Elder published his seminal work, *De agricultura*.

<sup>107</sup> M García Morcillo, 'Auctions, Bankers, and Public Finances in the Roman World' in Verboven et al, *Ancient World*, above n 12 at 257, 261.

<sup>108</sup> It is however not impossible that they appeared already earlier in that century. See Andreau, *Banking*, above n 55 at 31.

<sup>109</sup> Andreau, *ibid* at 33 speaks of the disappearance of the word 'by the time of the Tetrarchy', meaning 'leadership of four people', which is the division into four of the Roman Empire that took place under the reign of Emperor Diocletian in 297 CE and lasted until around 313 CE. See [www.en.wikipedia.org/wiki/Tetrarchy](http://www.en.wikipedia.org/wiki/Tetrarchy).

<sup>110</sup> See in general, J Andreau, *La Vie Financière dans le Monde Romain: Les Métiers de Manieurs D'argent* (Rome: École française de Rome Palais Farnèse, 1987) at 163 (hereafter: Andreau, *La Vie*).

highest available price.<sup>111</sup> A distinction existed between a public and private auction. The former was in connection with the collection of debts from an impecunious or insolvent debtor; the latter was a method of distributing goods in the market place. In other words, the former was a forced sale while the latter was voluntary. As outlined immediately below, in a private auction, the transmission of money from the buyer to the owner, was carried out by a receiver-banker, who in the process, may have extended credit to the buyer.<sup>112</sup>

A private auction was presided by a public crier, the *praeco*,<sup>113</sup> who awarded the object to the highest bidder.<sup>114</sup> As a receiver, a *coactor* transmitted payment from the successful bidder, namely, the buyer, to the owner. The *coactor* may have paid the owner either out of funds obtained by him in advance or collected from the buyer for the purpose of making the payment to the owner. Having received money from a bidder earmarked for payment in an auction, a receiver did not keep it separately but mixed it with other funds. Effectively, an advance payment by a would-be bidder had thus been made into an 'irregular deposit' with the receiver,<sup>115</sup> who then became indebted to the bidder for the amount of that deposit. Upon the acceptance of a bid and thus the conclusion of the sale to that bidder, the receiver either paid or undertook to the owner of the item sold to pay the amount of the bid. Any amount deposited with the receiver, which remained unused, either because it was above the amount of an accepted bid or for a bid that was not accepted, was owed by the receiver to the depositor.

Alternatively in an auction, with the view of either expediting payment to the owner or enhancing his security, an *argnetarius* may have paid the owner, either promptly, or pursuant to an obligation he incurred to him. Either way, payment by the *argnetarius* to the owner, and other than where funds were on deposit with the *argnetarius*, collection by the *argnetarius* from the buyer, were made through a *coactor*. In the further alternative, the *argentarius* may have extended

<sup>111</sup> According to García Morcillo, above n 107 at 257–58, not only private sellers but also 'the public authorities frequently used this method in transfers of goods or services.' This is explained 'by its effectiveness as a means of advertising and by the incitement to competition involved on the part of potential buyers, thus assuring the best possible price to the seller', as well as by '[t]he transparency of the procedure directed by a mediating officer . . . [which] guaranteed the delivery of the object in question', *ibid* at 257. The mediating officer is the crier or *praeco* identified in text and n 113 below.

<sup>112</sup> See in general, H Cancik and H Schneider (eds), *Brill's New Pauly Encyclopedia of the Ancient World: Antiquity* (Leiden-Boston: Brill, 2003) vol 2 at 331 (v. 'Auctiones'). See also G Humbert, 'Auctio' in CH Daremberg and E Saglio (eds), *Dictionnaire Des Antiquités Grecques et Romaines* (Graz: Akademische Durck-u. Verlagsanstalt, 1969) vol I, Part 1 at 543.

<sup>113</sup> '*Praecones*' were criers or heralds. They belonged to the auxiliary staff of higher magistrates whose orders they announced publicly. They also made public events which interested the population and assisted in public auctions. See Berger, above n 77 at 641 (v. '*Praecones*').

<sup>114</sup> For the mechanism, various participants, and legal aspects, see H Ankum, 'Quelques problèmes concernant les ventes aux enchères en droit romain classique' in *Studi in onore di Gaetano Scherillo* (Milan: Instituto Editoriale Cisalpino-La Goliardica, 1972) vol I at 377; JAC Thomas, 'The Auction Sale in Roman Law' 1957, *Juridical Review* 42; and in A Petrucci, 'Riesame del Ruolo dei Banchieri nelle *Auctiones* Private nel Diritto Classico Romano' in Verboven et al, *Ancient World*, above n 12 at 277 [in Italian] of which I had the benefit of a partial unofficial English translation.

<sup>115</sup> For the irregular deposit in Roman law, see ch 5, section 2 below.

short-term credit to the buyer, paying the owner, either promptly or in pursuance of an obligation incurred by him, with the proceeds of a loan made to the buyer, usually but not necessarily out of deposits taken by the *argentarius* from the public. In such a case as well, the *argentarius* used a *coactor* for both paying the owner, and other than where funds were on deposit with the *argentarius*, collecting from the buyer. Finally, in connection with all such options, a *coactor argentarius* merged the two functions, that of a *coactor* and an *argentarius*. The *coactor argentarius* thus acted as a receiver, could act as a lender, and could either pay promptly to the owner or incur payment liability to him.<sup>116</sup>

Among the four categories of bankers, only the *nummularii* did not participate in auctions. *Coactores* acted as mere receivers; they did not lend money to bidders and were always paid by them in advance. Conversely, *argentarii* advanced short-term loans to buyers, for a period of a few months, up to a year. Having combined both professions, *coactores argentarii* were both receivers and short-term lenders to buyers.<sup>117</sup> An *argentarius* or a *coactor argentarius* played a major role in an auction, beyond that involved in the transmission of funds and the extension of credit; rather, he ‘organised, regulated and financed the sale.’<sup>118</sup> In the process, each banker obtained a commission from the owner for his respective services. A banker taking part in an auction was officially responsible for keeping detailed registers relating to these auctions (*tabulae auctionariae* or *auctionales*); he would note down in such registers dates, detailed descriptions of the objects bought and sold, their prices and the names of the respective sellers and buyers.

As indicated, at various times, deposit banking was practiced in Rome by the *argentarii*, *nummularii*, and the *coactores argentarii*. Among the four categories of bankers, only the *coactores* were not depositaries. Invariably, the word *argentarii* had acquired a secondary broad sense to denote deposit bankers of all categories. As a discrete business activity, deposit banking included acceptance of deposit, lending deposited funds,<sup>119</sup> and carrying out withdrawal and payment orders issued by depositors.<sup>120</sup> Deposits were taken for safekeeping, namely, not in connection with individual payments to be carried out; yet, deposits made with the view of keeping funds available for payments as they may come did not bear interest.<sup>121</sup> Lending deposited funds by a depositary to third parties was in the depositary’s name and right and thus at his own exclusive risk; lending by the depositary to third parties was of no legal concern to the depositor, to whom the depositary remained strictly liable for the entire

<sup>116</sup> Legal aspects pertaining to obligations incurred in an auction are set out in the last paragraph of ch 5, section 6.1 below.

<sup>117</sup> Andreau, *La vie*, above n 110 at 163.

<sup>118</sup> Thomas, above n 114 at 44.

<sup>119</sup> For loans made in Rome by *argentarii* out of customers’ deposited funds see eg Toutain, above n 65 at 249.

<sup>120</sup> For the payment in and out of bank of deposits, see Andreau, *La vie*, above n 110 at 561–83.

<sup>121</sup> As in connection with Ancient Greece (see above at n 69), the question of interest paid on investment (as opposed to payment) accounts is contested.

outstanding balance, consisting at any given moment of total deposits less withdrawals.<sup>122</sup>

Deposit bankers operated under strict bookkeeping requirements, and were obligated to record their monetary operations in account books, called *rationes*. An account book (*ratio* in singular) was also known as a *ratio accepti et expensi* ('an account of deposits and payments') and *ratio implicita proper accepta et data* ('a complex account including both deposits and payments'). There is an unsettled controversy as to whether entries were made to the *rationes* separately for (namely under the name of) each client or 'globally' in a strict chronological order as they were made; and yet this record to which entries were posted may in fact be considered to be the forerunner of the ledger reflecting the bank account. A deposit banker was required to make such books available for production in a trial involving a client, even where the deposit banker was not a party to the litigation.<sup>123</sup> In the final analysis, the deposit banker was obligated to maintain books, to account for the various entries, and to state the balance owed between himself and the customer.<sup>124</sup>

A depositor could withdraw cash or else, acting as a payer, issue to his banker a payment order instructing payment to a payee. Both *argentarii* (broadly defined to include *nummularii*, as well as *coactores argentarii*) and *coactores* received instructions orally as well as in writing. A payee unknown to the payer's banker would present himself bearing some kind of token by which he could be recognized. And yet, as a rule, a banker acted on the basis of a payment order issued to him directly by the depositor; a payment order issued by the payer to the payee and presented by the payee to the payer's bank, like the modern cheque, was unknown in the Latin-speaking Roman world, at least as a standard practice.<sup>125</sup> In short, by reference to the classification of payment mechanisms discussed in chapter one, section 4.1 (ii) above, the Roman payment system was dominated by credit and not debit transfers.

Evidence for non-cash payments between two accounts is scant; in any event, a non-cash payment could have been carried out between accounts of two depositors, either in the same bank, or in two banks situated in the same small town or within a specific market, whether permanent or periodic. There was neither an inter-city nor intra-city multilateral interbank clearing and settlement system,<sup>126</sup> and yet interbank payments were feasible, primarily, though not exclusively, within the same city, on the basis of correspondent accounts held by bankers with each others.

<sup>122</sup> For the transformation in conceptualizing the bank-of-deposit's liability from that on a loan to that on an irregular deposit, which ultimately became understood as not dissimilar to that on a loan, see ch 5, section 2 below.

<sup>123</sup> See Berger, above n 77 at 366–67 (v. 'Argentarii').

<sup>124</sup> Guillard, above n 80 at 52 sets out these obligations and discusses them at length at 52–79.

<sup>125</sup> Notwithstanding Guillard, *ibid* at 40 to the contrary, whose view on the point may nevertheless be based on mistranslation of Greek and Latin terms. See Andreau, *La vie*, above n 110 at 572–73.

<sup>126</sup> See Andreau, *Banking*, above n 55 at 43.

Invariably, payments were made by banks to payees in cash. A payee would be advised by a bank receiving funds for him as to arrival of such funds, available for withdrawal by him. Unlike in the Greek world, no specialized documentation evolved as to advice of payment and discharge, though certainly such documentation existed. The various legal methods developed by Roman law, for making the banker liable for the payee, will be discussed below in chapter five.

In the final analysis, by reference to institutions and facilities known earlier to the Greeks, no major progress may be noted in the Roman World. Similarly, no major progress may be noted in the Roman World by reference to both the earlier and contemporaneous Hellenistic World, particularly Egypt, discussed in the following section. Certainly, compared to classic Greece, the institutional scene in Rome was more complex; and yet, this complexity did not lead to advancement in bank practices. In fact, with respect to the development of standard documentation and terminology, the reverse is true; richer technical vocabulary and more sophisticated standard terminology are said<sup>127</sup> to have existed in classic Greece as well as in the Hellenistic World. As well, from an institutional perspective, and as a reflection of the predominance of coin usage pointed out earlier in this section, having been familiar with developments in Egypt, the Romans nevertheless 'either failed or did not attempt to establish a unified state banking system.'<sup>128</sup>

Nevertheless, compared to Ancient Greece, lack of major progress in Roman banking practice is not without noteworthy exceptions and any statement to that effect must thus be qualified. In two major respects Roman banking practice went beyond that of the Greek. First, the receiver-banker could be treated as the first money transmitter. However, money transmission by a receiver-banker may have developed under narrow circumstances, in the context of auctions, and in any event did not extend to cover a payment between distant parties. Second, nascent interbank correspondent arrangements, under which one bank held funds in an account with the other, became standard practice; particularly, this facilitated payments between distant parties. Indeed, as will be seen below in chapter five, section 10, Roman banking practice developed multiparty applications for mechanisms facilitating the circulation of credit as well as payment between distant parties. It is, however, judged better to deal with such arrangements later on in this study, so as to demonstrate adaptability of legal structures that developed to apply to the simpler 'standard' three-party payment mechanisms to cover the more complex multiparty ones.

<sup>127</sup> With respect to technical vocabulary of banking operations, see eg Andreau, *Banking*, *ibid* at 582.

<sup>128</sup> Davies, above n 15 at 92. For a critique of his other observation as to the failure of the Romans to establish a centralized giro system in the footsteps of that alleged to exist in Egypt, see section 5 below.

## 5. GRECO-ROMAN EGYPT

In Ancient (Pharaonic) Egypt, money circulated only to a limited extent;<sup>129</sup> payments were made predominantly in kind.<sup>130</sup> Coined money began to prevail in Egypt after its conquest by Alexander the Great in 332 BCE.<sup>131</sup> Thereupon, Hellenism, the fusion of Greek and Eastern civilizations,<sup>132</sup> came to Egypt. Following Alexander's death in 323 BCE, and after the ensuing partition of his empire, Egypt fell into Ptolemy's hands. His successors, the Ptolemies,<sup>133</sup> ruled Egypt until 30 BCE when the country was conquered by the Romans. With the partition of the Roman Empire in the course of the fourth century CE, the Byzantines succeeded the Romans;<sup>134</sup> they stayed in power until 642 CE, when the Arabs took over and the Islamic epoch commenced.<sup>135</sup> For Egypt, the entire era of close to a millennium, between Alexander the Great and the introduction of Islam, is loosely referred to as Greco-Roman.<sup>136</sup> Throughout that era, the seat of the central Government was Alexandria.

Public granaries in Greco-Roman Egypt operated a countrywide system of payment in agricultural products, such as oil and wine; particularly however, they ran grain warehouse banking, facilitating payments out of and into deposits of grain,

<sup>129</sup> R Bogaert, 'Les Modèles des Banques Ptolémaïques' (1983) in R Bogaert, *Trapezitica Aegyptiaca, Recueil de Recherches sur la Banque en Égypte Gréco-Romaine* (Firenze: Edizioni Gonelli, 1994) (hereafter: *Trapezitica*) at 33. In fact, 'Egypt was the last of the countries of high culture in the Eastern Mediterranean area to adapt itself to the use of coined money'. Westermann, above n 47 at 31. For exchange in Egypt prior to the adoption of coined money see ch 2, text and nn 45 and 51 above.

<sup>130</sup> More specifically, in Ancient Egypt, economic exchange was predominantly done on a barter basis. Nevertheless, various types of sticks or staves, copper objects and gold served as a limited medium of exchange. See Einzig, above n 19 at 193–202.

<sup>131</sup> According to K Vandorpe and W Clarysse, 'Egyptian Bankers and Bank Receipts in Hellenistic and Early Roman Egypt' in Verboven et al, *Ancient World*, above n 12 at 153, 153–54, 'Actual money was introduced in Egypt in the late fifth century BC, when imitations of Athenian tetradrachmas, staters and other silver coins were minted in Egypt, first to pay Greek mercenaries and later perhaps to a limited extent also within the native economy.'

<sup>132</sup> For periods in Ancient Greece, see n 50 above.

<sup>133</sup> Or the Lagides, after Lagide, the father of Ptolemy. See eg [www.fr.wikipedia.org/wiki/Dynastie\\_des\\_Ptol%C3%A9m%C3%A9s](http://www.fr.wikipedia.org/wiki/Dynastie_des_Ptol%C3%A9m%C3%A9s).

<sup>134</sup> As of 395 CE Roman Egypt was part of the Eastern Empire, based in Byzantium (present-day Istanbul). The partition is alluded to above in n 88.

<sup>135</sup> This historical sketch draws on [www.presidency.gov.eg/html/history.html](http://www.presidency.gov.eg/html/history.html) and [www.en.wikipedia.org/wiki/Alexander\\_the\\_Great](http://www.en.wikipedia.org/wiki/Alexander_the_Great). See also [www.en.wikipedia.org/wiki/Roman\\_Empire](http://www.en.wikipedia.org/wiki/Roman_Empire) and [www.en.wikipedia.org/wiki/Muslim\\_conquests](http://www.en.wikipedia.org/wiki/Muslim_conquests).

<sup>136</sup> In the West, the Greco-Roman era, characterized by a fusion between the Greek and Roman civilizations, begins with the fall of Greece to the hands of Rome in 146 BCE. See in general, [www.wikipedia.org/wiki/Greco-Roman](http://www.wikipedia.org/wiki/Greco-Roman). From this perspective, the Greco-Roman period in Egypt roughly extends between 30 and 312 CE (with the latter date possibly referring to a stage in the division of the Empire that preceded its formal partition). See [www.pw1.netcom.com/~aphilipp/house001.htm](http://www.pw1.netcom.com/~aphilipp/house001.htm). However, in the East, Greco-Roman fusion gave rise to a modified Hellenism, with the earlier Greek component superseded by a Greco-Roman one. Arguably, this dominance by one culture, though in a transformed form, justifies the entire era of Greek and Roman influence, to be called 'Greco-Roman'.

for both public authorities and individuals.<sup>137</sup> Numerous scattered government granaries were connected by the Ptolemies into a network of grain depositaries. The system maintained grain accounts and recorded transfers. For each yearly harvest of each type of grain the various deposits were physically amalgamated so that credit to an account reflected a claim to a share in the mixture rather than to a physically segregated or separate deposit; it seems though, that no lending was made out of the mixture, so that full reserve was held to back all credits to the deposit accounts.<sup>138</sup>

Transfer could occur between accounts in the same granary, same region, or different regions. Regardless, transfers were commonly book-based. Particularly with the view of avoiding the cost of physical transport, even an inter-granary transfer, whether or not in the same region, was not accompanied by a physical delivery of grain between the granary of the transferor to that of the transferee. Rather, in each case of an inter-granary transfer, an adjustment was made not only to transferor's and transferee's accounts, but also over a system of inter-granary accounts.<sup>139</sup> A comprehensive account management system thus existed in each granary, in each region, as well as in Alexandria, from which the entire system was overseen. Effectively, this was the forerunner for a nationwide credit-push giro mechanism,<sup>140</sup> under which payment orders were executed by means of crediting and debiting accounts. It is also said that circulating credit notes attesting to credit posted to a grain account may have been used as payment devices.<sup>141</sup> The system was however doomed to wither away together with the disappearance of specie and kind as universal mediums of exchange.<sup>142</sup>

<sup>137</sup> The system is concisely described by C. Préaux, *L'Économie Royale des Lagides* (Bruxelles: Édition de la Fondation Égyptologique, 1939) at 142, as well as by MI Rostovtzeff, *The Social & Economic History of the Hellenistic World* (Oxford: Clarendon Press, 1941) vol II at 1287. See also Davies, above n 15 at 52–55 and Westermann, above n 47 at 32–33. The authoritative text relied on by all is in German: F. Preisigke, *Girwesen im Griechischen Ägypten* (Strassburg: Verlag von Schlesier & Schweikhardt, 1910, reprint Hildesheim, New York: Georg Olms Verlag, 1971), discussing the grain giro system at 62–184, particularly at 89–92, 101–02, and 128–30 (see also relevant translated documents reproduced at 147–73), in connection with which I had the benefit of a partial unofficial translation.

<sup>138</sup> For this understanding of the system (on the basis of Westermann's article, above n 47) see JC Williams, 'Fractional Reserve Banking in Grain' (1984), 16 *Journal of Money, Credit and Banking* 488, at 488, fn 1.

<sup>139</sup> Eg, a transfer from a Depositor A in Granary A to a depositor B in Granary B, resulted not only in an adjustment of the Depositors' accounts, but also in an adjustment that reflected the claim of Granary B on Granary A where the grain in the amount of the transfer remained kept.

<sup>140</sup> 'Giro' (coming from Greek *'gigros'*, and meaning ring, circular or cyclical) usually narrowly denotes a 'credit-push' mechanism for a non-cash payment between two accounts (as in [www.en.wikipedia.org/wiki/Giro](http://www.en.wikipedia.org/wiki/Giro)). Alternatively, it may more broadly denote any bookkeeping transfer (as in Westermann, above n 47 at 49) or transfer operations (as in Rostovtzeff, above n 137 at 1279). In this latter (broad) sense it is any non-cash payment between two bank accounts, regardless of whether it is 'credit-push' or 'debit-pull' mechanism. See ch 1, section 4.1, particularly (ii) above.

<sup>141</sup> See eg RS Bagnall and R Bogaert, 'Orders for Payment from a Banker's Archive: Papyri in the Collection of Florida State University' (1975), in *Trapezitica*, above n 129 at 240. No mention of such credit notes appears in Preisigke, above n 137.

<sup>142</sup> And yet, a temporary revival of grain banking, consisting also of lending out of amalgamated deposits, occurred in Chicago in the course of the nineteenth century. See Williams' article, above n 138.



Indeed, 'the practice of settling accounts in hard cash or by banking operations became general in the Hellenistic world.'<sup>143</sup> So far as the monetary economy was concerned,<sup>144</sup> Greco-Roman Egypt is reputed to have excelled at various types of banking institutions, extensive bank networks and diverse banking operations.<sup>145</sup> To a large extent, in its essence, the banking system was modelled on its Greek predecessor, set out above in section 3, though in the details, it substantially further evolved. Evolution took place in the context of overall economic and financial advancements in the Hellenistic World. Thus, during the Hellenistic period, credit expanded; it was extended also by private money lenders and temples. As in Ancient Greece, the latter did not lend out of deposits; namely they did not act as intermediaries; rather they lent out of consecrated funds kept by them (that is, their capital). At the same time, in departure from Ancient Greece, temples in Greco-Roman Egypt also lent out of funds donated to them and consecrated to their management by a specific 'founder', effectively as a separate or segregated trust fund. In lending such funds, temples endeavoured to adhere to the terms attached to the donation, but nevertheless were not liable to the founder for the repayment of the funds. Furthermore, unique patterns of collaboration among all credit extenders manifested themselves; in the framework of such patterns, banks played an enhanced role in pooling and redistributing funds.<sup>146</sup>

Moreover, as will be noted further below, more specifically with respect to Egypt, State banks formed a network and assumed a unique role in carrying out treasury operations for the central Government and other public authorities. It is thus not surprising to see a larger and more diversified banking sector as well as an increased banking activity, including in carrying out and receiving payments. Perhaps it is against this background that banking continued to thrive in Egypt

<sup>143</sup> Toutain, above n 65 at 165.

<sup>144</sup> For the limited range of operations in kind or specie of banks (in addition to the public granaries) in Greco-Roman Egypt, see R Bogaert, 'Les Opérations en Nature des Banques en Égypte Gréco-Romaine' (1988), *Trapezitica*, above n 129 at 397.

<sup>145</sup> R Bogaert researched and wrote extensively on the subject. His work, consisting of 20 articles, mostly in French, to 1994 (originally published elsewhere) is collated in his *Trapezitica*, above n 129. Six subsequent articles (which are thus not part of the collection) are 'Liste Géographique des Banques et des Banquiers de l'Égypte Romaine, 30A – 284', (1995), 109 *Zeitschrift-für Papyrologie und Epigraphik* 133; 'La Banque en Égypte Byzantine' (1997), 116 *Zeitschrift-für Papyrologie und Epigraphik* 85; 'Les Opérations des Banques de l'Égypte Ptolémaïque' (1998), 29 *Ancient Society* 49; 'Liste Géographique des Banques et des Banquiers de l'Égypte Ptolémaïque' (1998), 120 *Zeitschrift-für Papyrologie und Epigraphik* 165; 'Les Opérations des Banques de l'Égypte Romaine' (2000), 30 *Ancient Society* 135; and 'Les Documents Bancaires de l'Égypte Gréco-Romaine et Byzantine' (2001), 31 *Ancient Society* 173. Bogaert commenced the first of these last six articles ('Liste Géographique' (1995), *ibid* at 133 text at n 1) by conceding that for health reasons he had abandoned his plan to synthesize his extensive research on banks in Greco-Roman Egypt into a monograph. Unfortunately he died in October 2009. Certainly however his work in the area is the foundation of both subsequent research as well as the analysis in this section. A recent work covering the first part of the period is S von Reden, *Money in Ptolemaic Egypt: From the Macedonian Conquest to the End of the Third Century BC* (Cambridge: Cambridge University Press, 2007) at 257–96.

<sup>146</sup> V Gabrielsen, 'Banking and Credit Operations in Hellenistic Times' in ZH Archibald, JK Davies, and V Gabrielsen (eds), *Making, Moving and Managing: The New World of Ancient Economies* (Oxford: Oxbow Books, 2005) at 136.



even after 212 CE, a year in which banks disappeared from the rest of the Greek World.<sup>147</sup> A separate treatment of banking in Greco-Roman Egypt is thus well justified.

At the same time, a regression occurred in one fundamental respect. In departing from their Greek and Roman predecessors, banks in Greco-Roman Egypt scarcely acted as lenders in their own name and right; rather, they acted as brokers facilitating lending made by their depositors to borrowers. The typical loan, though out of funds deposited with a bank, was effectively made to a borrower by the depositor; it is the latter, and not the former, who stood to profit or bear the risk of default by the borrower. In short, banks accepted deposits as well as executing and receiving payments for their depositors but hardly lent;<sup>148</sup> effectively it is not disputed that at least for most of the period,<sup>149</sup> they acted as brokers and not as true financial intermediaries, or 'banks' in the full sense of the word.<sup>150</sup>

Banking institutions in Greco-Roman Egypt were classified as (i) private banks, (ii) leased banks, and (iii) banks run by the authorities. Some of the banks run by the authorities were in fact treasury departments of the Government; yet, they carried out banking operations, on some occasions noted below even for individuals, and in any event were treated by contemporaries as banks; hence the justification for dealing with them as such. Over the years, changing political, socio-economic and administrative conditions brought upon institutional modifications as well, though only in the sub-classification of the above mentioned categories.

Originally, *private bankers*, accepting deposits and making and receiving payments on behalf of individuals, were *trapezitai*. Primarily during the

<sup>147</sup> For the impact of the political, economic and monetary crisis in the rest of the Empire, see Bogaert, *Banques et Banquiers* above n 48 at 31–33. In 'La Banque en Égypte Byzantine', above n 145 at 85 Bogaert points out that Egypt enjoyed agricultural prosperity and had not been invaded and thus suffered from the crisis less than other parts of the Empire. In the West, banks persisted for close to 200 years after 212 CE, and in the border area between the Western and Eastern Empires, even longer. See in section 4, text at nn 111–12 above.

<sup>148</sup> For private banks during the Roman era the point is vigorously made by F Lerouxel, 'La Banque Privée et le Marché du Crédit dans les Tabletes de Murecine et les Papyrus d'Égypte Romaine' in Verboven et al, *Ancient World*, above n 12 at 169, 171. For Bogaert's observations to a similar effect with regard to the Ptolemaic as well as Roman eras, see respectively, 'Les Opérations des Banques de l'Égypte Ptolémaïque', above n 145 at 142 (as well as 128), and 'Les Opérations des Banques de l'Égypte Romaine', above n 145 at 240 (as well as 207). Lending is hardly documented as a banking activity in 'La Banque en Égypte Byzantine', above n 145 (though see eg at 127 in connection with the *collectarios*). For the limited lending activity of private banks in the Ptolemaic era see Bogaert, 'Les Opérations des Banques de l'Égypte Ptolémaïque', *ibid* at 110–11 and 122.

<sup>149</sup> But *cf* Von Reden, above n 145 at 280 who claims that during the Ptolemaic era in Egypt 'bankers used their deposits to . . . make loans.' At the same time, she concedes, that 'there seem to have been no clear rules about whose money they were permitted to use for what purposes and under what conditions.' *Ibid*. She also concedes, *ibid* at 290, that '[m]ore regularly than offering loans, banks [in Ptolemaic Egypt] facilitated payments in a commercial and managerial context'.

<sup>150</sup> To that end, as pointed out by Lerouxel, above n 148 at 172, for Egypt, Bogaert changed his original definition of 'banker' (given in *Les Origines*, above n 11 at 30) by deleting (in both 'Les Opérations des Banques de l'Égypte Ptolémaïque', *ibid* at 135 and 'Les Opérations des Banques de l'Égypte Romaine', *ibid* at 216) any reference to the extension of credit.

Ptolemaic era, their rise, decline and survival, has been strongly linked to their own involvement in money change. With the assignment of money change exclusively into the hands of franchised monopolies around 259 BCE, those *trapezitai* who had not become franchised monopolies, were required to cease their banking operations, which led to their demise. This may explain, at least in part, the relocation of commercial bank functions to the royal banks and franchised monopolies, to be discussed further below. Private moneychangers reappeared however towards the end of the third century BCE, before the advent of the Romans. Moneychangers who became bankers were said to operate exchange banks, or *kollysbistikai trapezai* of which we hear as of the second century BCE. Another type of changer-banker, the *collectarios*, surfaced during the Byzantine period.

In any event, *trapezitai* also existed during the Roman and Byzantine periods. During the Roman era, in the footsteps of the *coactores argentarii* in the West,<sup>151</sup> they also acted as bankers-receivers in auctions; in fulfilling this function they were called *komaktores*, a term derived from the Latin *coactor*.<sup>152</sup> During the Byzantine era, *trapezitai* primarily served small merchants. At the same time, new types of private bankers, serving the upper classes, emerged during the Byzantine period. Those were the *argyroprates* (from the Latin *argentarius*), and *trapezitai* of large estates; the latter served the landowners, particularly in providing financial administration for the estates.

As of around 259 BCE, money changing had been exclusively in the hands of franchised monopolies; these were banks leased out by the authorities to individuals.<sup>153</sup> Particularly, they handled the change between the various denominations. As essayers, they fulfilled an important function in the elimination of counterfeit coins. They may also have been, to some extent and subject to unknown conditions, money lenders. During the Hellenistic period, such banks, modelled on predecessors from the classic era,<sup>154</sup> existed only in Egypt.<sup>155</sup> In any event, there is no mention of franchised monopolies after 243 BCE, and they may have disappeared towards the end of the third century BCE. Their extinction may be explained by the introduction of a copper standard in 210 BCE, which had precipitated payments in specie, thereby leading to the temporary disappearance of circulating coins, and hence to the redundancy of franchised monopolies, whose main line of business thus vanished. It seems that shortly thereafter, when coined money reappeared and the money change function resurfaced, franchised monopolies were no longer around, and money change, and its attached task of money essaying, was taken over by private bankers.

<sup>151</sup> For the *coactores argentarii* in the West see text and nn 108–10 and 117 above.

<sup>152</sup> For the *komaktor* in Roman Egypt, see García Morcillo, above n 107 at 270–75. I suppose that, compared to the West, this activity of private bankers in Roman Egypt was less substantial.

<sup>153</sup> Which is, in essence, a free translation of Bogaert's 'les banques affermées'.

<sup>154</sup> See beginning of section 3 above.

<sup>155</sup> Bogaert, *Banques et Banquiers*, above n 48 at 401.

*Banks leased out to individuals* surfaced during Roman times, in the course of the second and third centuries CE. They however were not given a franchised monopoly, at least as a matter of law, though as a matter of fact, such monopoly may have been occasionally enjoyed. In any event, at least on one occasion and perhaps all, such banks were ultimately taken over and run directly by the authorities. Presumably, no leased banks operated during the Byzantine era.

*Banks run by the authorities* in Greco-Roman Egypt fell into several groups; however, over the years, particularly with the advent of each period, namely the Ptolemaic, Roman and Byzantine periods, classification had changed to reflect political and administrative modifications as they occurred. Thus, during the Ptolemaic era, banks run by the authorities were royal banks, village banks, and the *logeutérion*. A Royal bank was modelled on the Greek State-owned bank run for public interest, the *demosia trapeza*.<sup>156</sup> In their Egyptian incarnation, royal banks were called *basilikai trapezai*; they were located in the large cities and primarily served the State. Their principal task was to make and receive payments for the king; and yet they also kept accounts for individuals. They operated in conjunction with a network of village banks, which as explained immediately below, effectively operated for them as branch offices, or more precisely, as points of collections and disbursements of funds,<sup>157</sup> in villages and small towns throughout the various districts of the country. The tax system was operated by the *logeutéria*; each *logeutérion*, or tax collection office, was dependent on a respective royal bank in a city and a village bank in a village or small town.

Deposits made at village banks (including the *logeutéria*) were centralized at the royal bank for the respective district, out of which public spending for the district took place. To that end, money deposited with a village bank was periodically shipped to its respective royal bank.<sup>158</sup> As well, at the end of each monthly cycle, information covering all deposit and withdrawal activity was communicated from a village bank to its royal bank.<sup>159</sup> Effectively then, village banks maintained for their customers sub-accounts whose balances were brought to zero at the end of each monthly cycle. At any point of time during each cycle, the amount available for withdrawal from a sub-account was up to a balance consisting of deposits less withdrawals made from the beginning of the cycle. For each customer/account holder, at the end of a monthly cycle, any remaining balance in a sub-account at a village bank was transferred to the respective royal bank where it was added to the balance available in that customer's main account.

<sup>156</sup> See section 3, text around n 60 above.

<sup>157</sup> From a modern perspective, they were not 'bank branches' as per the explanation that immediately follows, they did not maintain on their books the principal accounts of their customers.

<sup>158</sup> Bogaert, 'Liste Géographique des Banques et des Banquiers de l'Égypte Ptolémaïque' above n 145 at 167.

<sup>159</sup> Bogaert, 'Les Documents Bancaires de l'Égypte Gréco-Romaine et Byzantine', above n 145 at 189.

A surplus in an account of the king in a royal bank, however, may have been physically shipped to the Royal Treasury, or the *basilicon*, in Alexandria.<sup>160</sup> However, the *basilicon* did not serve as a central bank;<sup>161</sup> it neither maintained accounts for all deposits throughout the country, nor received surplus balances for such accounts, other than for the king, who effectively moved excess money from his diverse accounts at royal banks, into the *basilicon*. Nor did the *basilicon* oversee the operation of the entire network; it did not even maintain accounts for the various royal banks into which adjustments for inter-district transfers could be made. Rather, each royal bank kept a separate set of records for its own account holders. Effectively, together with its village bank network, a royal bank operated as a standalone independent bank. It follows that there was no infrastructure facilitating a countrywide system for inter-district non-cash payments from an account in one royal bank into an account with another royal bank.

In the course of the Roman era, the royal bank became a public bank,<sup>162</sup> in fact, reverting to its Greek original name, *demosia trapeza*. The *nomarch* bank, called after the highest official in a district ('*Nome*'),<sup>163</sup> corresponded to the Ptolemaic *logeutérion*. A new type of bank run by authorities, the municipal bank, surfaced. Village banks continued to exist. Finally, during the Byzantine period, village banks disappeared, municipal banks remained, and the public bank (successor of the Ptolemaic royal bank) became the district ('*Nome*') bank. However, in connection with administrative reform precipitated during Diocletian's reign (284–305 CE), Egypt was divided into provinces, each incorporating several smaller units;<sup>164</sup> in the aftermath, the *Nome* Bank was gradually superseded by a new public provincial bank. As well in the Byzantine era, a new specialized bank, the General Bank, emerged; it was a government department particularly involved in public finance, such as the collection of taxes and their disbursement, including as wages for the civil and military service.

<sup>160</sup> Bogaert's tentative statement to that effect in 'Le Statut des Banques en Égypte Ptolémaïque' (1981), *Trapezitica*, above n 129 at 56 as well as in 'Recherches sur la Banque en Égypte Gréco-Romaine' (1987), *Trapezitica*, *ibid* at 6 is expressed more confidently in 'Les Opérations des Banques de l'Égypte Ptolémaïque', above n 145 at 117.

<sup>161</sup> Among others, this has been a contested point. The present analysis follows Bogaert, who on this issue determined against the existence of a central bank in Alexandria. For his view on the point, in conjunction with a survey of the debate, see eg R Bogaert, 'Le Statut des Banques en Égypte Ptolémaïque', *ibid* at 47.

<sup>162</sup> Unfortunately, terminology here is unsatisfactory. Per Bogaert, the Greek conception of a public bank covered both a State bank and a franchised monopoly. See text and nn 59–61 above. In this sense, the royal bank in Ptolemaic Egypt was a State bank, except that 'State bank' was broad enough to cover also both village banks and the *logeutérion*. At the same time, the use of 'public bank' to describe the Roman successor of the Ptolemaic royal bank is equally inappropriate, as per Bogaert's above-mentioned Greek conception, the term is broad enough to include a franchised monopoly (leased bank). Hence, a possible explanation for a limited continued use of 'royal bank' to cover also the Roman successor of the Ptolemaic royal bank, notwithstanding the inaccuracy of the 'royal' title in Roman times.

<sup>163</sup> For *Noms* and *Nomarchs* in Ancient, Ptolemaic and Roman Egypt, see eg [www.en.wikipedia.org/wiki/Nome\\_\(Egypt\)](http://www.en.wikipedia.org/wiki/Nome_(Egypt)).

<sup>164</sup> See eg *ibid* and [www.en.wikipedia.org/wiki/Diocletian#Conflict\\_in\\_the\\_Balkans\\_and\\_Egypt](http://www.en.wikipedia.org/wiki/Diocletian#Conflict_in_the_Balkans_and_Egypt).

During the Roman and Byzantine eras, banks operated by authorities, falling to any of the category discussed above, acted exclusively for public authorities and did not maintain accounts for individuals. For the public bank, as a successor of the Ptolemaic royal bank, this was a departure from the earlier Greek period.

Throughout the Ptolemaic era, royal banks maintained accounts for individuals. The franchised monopolies also took deposits. Deposit accounts were obviously run also by private banks.<sup>165</sup> Payment activity out of or into all such accounts is well documented; mostly it was, however, in cash. Nevertheless, available documentation also supports the existence of funds transfers from one account to another,<sup>166</sup> though only between accounts maintained in private banks<sup>167</sup> as well as for tax payments from accounts maintained in royal banks.<sup>168</sup> Documentation further supports the existence of bilateral correspondent relations between private banks, namely instances where one bank holds an account with another;<sup>169</sup> this could support inter-bank non-cash funds transfers. At the same time, there is no indication of any multilateral bank clearing arrangement; and certainly, recalling that even the various royal banks acted on a standalone basis rather than in a connected network, any claim to the existence in Ptolemaic Egypt of a 'centralized state giro system'<sup>170</sup> does not stand up to the results of Bogaert's meticulous empirical research.

The execution of payments was a distinct service provided by banks for their customers in the Ptolemaic era. 'More regularly than offering loans, banks facilitated payments in a commercial and managerial context'.<sup>171</sup> During that era, banks had an important role in 'stabilizing monetary transactions rather than transforming them. Their primary function was to increase the trust in money, to keep monetary funds safe in different places and to increase the convenience of discharging monetary obligations'.<sup>172</sup> However, the execution of payment orders was 'personalised, that is, dependent on . . . personal acquaintance' rather than on a standardized more anonymous system.<sup>173</sup>

In the ensuing Roman period, with the increase in number and significance of private banks, it became possible to make tax payments from accounts held not only in public banks but also in private banks.<sup>174</sup> No other significant improvements occurred in the course of both the Roman period and Byzantine era that followed. During the Roman era, deposit and payment activity is documented for both banks leased out to individuals and private banks. Payments made by

<sup>165</sup> Bogaert, 'Les Opérations des Banques de l'Égypte Ptolémaïque', above n 145, respectively at 113–16, 124–28, 135–42.

<sup>166</sup> *Ibid.*

<sup>167</sup> *Ibid* at 136–37.

<sup>168</sup> *Ibid* at 115.

<sup>169</sup> *Ibid* at 135. See below paragraph containing the one preceding n 189.

<sup>170</sup> Davies, above n 15 at 92.

<sup>171</sup> Von Reden, above n 145 at 290.

<sup>172</sup> *Ibid* at 294.

<sup>173</sup> *Ibid.*

<sup>174</sup> Bogaert, 'Les Opérations des Banques de l'Égypte Romaine', above n 145 at 250.

banks to third parties were typically in cash.<sup>175</sup> The same appears to be true for the Byzantine period.<sup>176</sup>

Extensive documentation is available in connection with bank payment activity throughout the entire era of Greco-Roman Egypt, albeit particularly for the Ptolemaic period.<sup>177</sup> During the entire Greco-Roman era, banks in Egypt issued documents that followed and developed patterns of earlier Greek counterparts, set out above in section 3.<sup>178</sup> For their part, customers issued to their banks payment orders either orally or in writing.<sup>179</sup> Indeed, in Greco-Roman Egypt we find the earliest written payment orders, at least as a reflection of a standard banking practice.<sup>180</sup> The oldest type of a Ptolemaic payment order is a 'double document', containing two orders identical at least in substance, written one above the other. A space of a few centimetres exists between the two texts. The upper text was rolled up and sealed. It would be open in case of a dispute as to the authenticity and the contents of the order. Each text included a standard opening and closing formula. For its part, the order to pay is followed by the payee's identification, the object of payment, the sum and the date. The banker's title to whom the order is addressed is not mentioned.

This double order for payment was probably in use only for some decades in the middle of the third century BCE. The single order of payment existed alongside it, but remained in use in the coming centuries of the entire Greco-Roman era. Its elements were similar to that of the double document, except that obviously the order was not duplicated. As well, starting during the Ptolemaic era, linguistic changes in the standard formula evolved over time. The order specifically refers to a payment in cash, which excludes a transfer from one account to another. As of 230 BCE, single order documents include the amount both in figures and words, arguably to avoid misunderstanding and prevent falsifications. In the Ptolemaic payment orders, sums are usually denominated in copper money. Orders may have been for either single or multiple payees and included the object of payment, either in the text itself, or as an attachment, frequently

<sup>175</sup> *Ibid*, respectively at 201–07 and 216–39 (as well as 255–56 and 258–64).

<sup>176</sup> Bogaert, 'La Banque en Égypte Byzantine', above n 145 particularly at 122–23.

<sup>177</sup> See K Geens, 'Financial Archives of Graeco-Roman Egypt' in Verboven et al, *Ancient World*, above n 12 at 133, 140–50.

<sup>178</sup> More so during the Roman era. See particularly Bogaert, 'Les Documents Bancaires de l'Égypte Gréco-Romaine et Byzantine', above n 145 at 238–50 (for private banks during the Roman era), and 259–64 (for leased banks in the Roman era). See also at 270 (for private *trapezitai* in the Byzantine era).

<sup>179</sup> For written orders see Bogaert, *ibid* at 194–98, 205–07 and 209–11 (respectively for royal and village banks, leased banks, and private banks during the Ptolemaic era); 236–37, and 253–58 (respectively for public and village banks, and private banks during the Roman era); and 271, 272–73, 278–79 (respectively for the private *trapezitai*, the *collectarioi* and the *trapezitai* of large estates in the Byzantine era).

<sup>180</sup> For detailed analysis see RS Bagnall and R Bogaert, 'Orders for Payment from a Banker's Archive: Papyri in the Collection of Florida State University', above n 141 at 219, and R Bogaert, 'Note sur l'Emploi du Chèque dans l'Égypte ptolémaïque' (1983) in *Trapezitica*, above n 129 at 245. See also R Bogaert, 'Recherches sur la Banque en Égypte Gréco-Romaine' (1987–89) in *Trapezitica*, *ibid* at 1; and R Bogaert, 'Les Opérations des Banques de l'Égypte Ptolémaïque', above n 145 at 141.

consisting of a copy of the document on the basis of which payment was made. As of the first century BCE, payment orders give the title of the banker to whom they are addressed. In some orders the banker is instructed to execute payment expeditiously.

During the Ptolemaic era, the account from which the payment is made may sometimes be specifically indicated. Some but not all orders are signed by the order giver/payer. As a rule, a payment order instructed a payment in cash.<sup>181</sup> In some orders the banker is instructed to issue a receipt to the order giver/payer, but none of the Ptolemaic orders contains a receipt written by the payee; the latter was to be written by the payee on a separate document.<sup>182</sup>

Variants of the formula for payment orders surfaced in the ensuing Roman-Byzantine periods. More documents are from the Roman era, particularly from the first two centuries CE; the declining banking activity thereafter is reflected in a significant reduction in payment orders available between the third and sixth centuries CE. The opening formula always mentions the title of the banker; in one case the banker is instructed to execute payment quickly. The payment order indicates the name of the payee, and usually also the object of payment. The object is either mentioned specifically, or by reference to the document on the basis of which payment is made; however, in contrast to the earlier Ptolemaic payment orders, no copy of such a document is ever attached. Per practice originating in 230 BCE, the amount is indicated in both figures and words. In departure from the earlier Ptolemaic documents, sums are usually payable in silver money. Documents are dated; in further departure from the Ptolemaic predecessors, payment orders from the Roman era do not contain a closing formula. Both the deposit from which payment is to be made and a request for receipt from the banker are rare; each appears in only a single document. Only one document is signed by the order giver/payer. In departure from the Ptolemaic predecessors, a few payment orders contain the payee's acknowledgement of payment; in a few others, the orders are cancelled by crossed lines.

All such payment orders were issued by payers directly to their respective bankers. By reference to the classification of payment mechanisms in chapter one, section 4.1 (ii) above, they initiated credit transfers. In contrast, a cheque is issued by the payer, a customer of the paying (drawee) bank, to the payee, who is to present it for payment to the payer's banker. The modern cheque collection, under which the payee collects the cheque through his bank is that of a debit transfer. As will be outlined below, in Antiquity, even in an inter-bank payment, the payee did not collect the cheque through his bank so that no debit transfer was involved. Rather, the cheque payment was that of a credit transfer. Nevertheless, the cheque of Antiquity carried the seeds of the modern cheque.

Thus, in Antiquity as nowadays, in contrast to the payment order issued directly by the payer to his bank, the cheque was issued by the payer to the payee

<sup>181</sup> Geens, above n 177 at 140.

<sup>182</sup> For such receipts, see Geens, *ibid* at 144.



who was to present it to the payer's bank. Typically, the cheque payment process does not require a separate communication from the payer to his bank and thereby enhances the flow of payment. Nevertheless, unlike the confirmation issued by a banker to the payee (in the case of a payment order issued to that banker by his customer, the payer), the issue of a cheque to the payee by the payer does not carry with it the assurance of payment by the banker.<sup>183</sup> Perhaps this, together with the enhanced falsification risk, discussed further below, may explain the paucity of cheques from the Ancient era; and yet, there is evidence of the operation of a cheque system in Ptolemaic Egypt.

A collection of 26 fragments of papyrus with Greek text, found in a mummy cartonnage in Abusir el-Melek may be the first evidence of a cheque system. Papyri contain written orders to bankers to pay a sum of money to third persons. They are from the close of the Ptolemaic era, or more specifically, from the first half of the first century BCE, most likely between 87 and 84 BCE. Their texts range from complete documents to very small fragments. All are written on fairly small pieces; the maximum size is  $14.5 \times 10.2$  centimetres; and most are smaller than  $10 \times 10$  centimetres. Each document contains the text of the order, usually in seven lines, and bears wide margins on all or most sides. Some papyri have writings on their back, but in no case is this writing earlier than that of the payment order, and in no case can enough be read to yield meaning. The collection as a whole is known as the Florida collection, following its acquisition by the Robert Manning Strozier Library of Florida State University (Tallahassee) in 1973. Professor Bagnall presented the collection in 1974; he subsequently provided a translation on which Professor Bogaert commented in a joint paper.<sup>184</sup>

Altogether, 24 payment orders, addressed to two respective bankers, were constructed out of the collection. The orders are addressed by various private customers to their bankers, very likely to private bankers. Their opening formula is that of late Ptolemaic and Roman times, and as is usual in the Roman texts, no closing formula exists in them. In form, they are closer to payment orders from the Roman era, and yet they belong to the Ptolemaic period; in fact, they bear similarities to instruments used in connection with payments out of grain deposits.<sup>185</sup> Most of the texts either specify copper or are for amounts which are in copper. As well, they are for relatively small amounts. Most of them are dated, address and identify the banker, as well as identifying both the payer and the payee. Their most striking features are the brevity of the text and ample use of abbreviations; they omit all mention of the reason or object for payment, do not indicate the deposit from which payment is to be carried out, do not bear signature, and do not indicate performance, namely, receipt of payment by the payee.

<sup>183</sup> For a cheque from Roman Egypt from 125 CE, giving rise to a dispute involving the unavailability of funds to cover payment, see Bogaert, 'Recherches sur la banque en Égypte Gréco-Romaine', above n 160 at 23.

<sup>184</sup> Above n 141.

<sup>185</sup> For the payment system associated with the Ptolemaic granary system, see above, text and nn 137–41.



Having elsewhere pointed to possible earlier origins for sparse use of cheques,<sup>186</sup> Bogaert asserts that the Florida collection is nevertheless the first evidence of a cheque system. Indeed, a payment order of any type is issued by a payer, who instructs his bank to make payment to a payee, and identifies the payee. Typically in the Ancient World, as is still the case today in the modern credit transfer system, the order was issued by the payer directly to the banker. Insofar as it embodies an order by a payer, addressed to his banker, to make payment to an identified payee, the cheque is a payment order; and yet, in contrast to the scenario just described, a cheque is issued directly to the payee, who becomes its first holder. It is the holder of the cheque (and not the payer) who subsequently presents it to the payer's banker. In fact, this is the basis for the method which still operates to this day for the payment of cheques.

According to Bogaert, the Florida collection demonstrates the existence of a non-transferable cheque system. Thereunder, the cheque did not circulate; nor could it be collected through a deposit at the payee's account with another bank. Rather, the procedure for payee-holder, to whom the cheque was issued, was to present the cheque to the payer's bank, either in person or through an agent, and collect payment, usually in cash. However, in principle, the payment in cash of the non-transferable cheque of Antiquity could be bypassed by means of a credit posted to the payee's account in one of two cases. First, such could be the case where the payee held his account at the same bank that also maintained the payer's account. Second, as discussed further below,<sup>187</sup> under limited circumstances, a mechanism existed for facilitating the payment by means of a credit transfer into the payee's account at a bank other than that of the payer.

The issue of a payment order by a customer, directly to his bank, typically involved a direct contact between the two. A customer could give the order either orally and in person, or in writing; a written order was likely to be sent physically closed and sealed, and to bear the banker's name on its verso. Under each such procedure, the risk of fraud was reduced. In contrast, irrespective of how the payee was paid, the presentment of a cheque by the payee to the payer's bank did not involve a direct contact between the bank and its customer, the payer. Obviously, lack of direct contact between the payer and his bank increased the risk of falsification. This remains true today; it was more so in Antiquity, where the instrument may have been written by a scribe, and not in the handwriting of the payer, and could have been unsigned.

Bogaert speculates that payment by cheque was usually made to a payee either known to the payer's bank, or adequately identified, with great precision, in the cheque. In effect, this must be true also for a payment order issued directly to the banker, except that payment under it to the payee could be made in the presence of the payer, a procedure which would have defeated the purpose of a cheque.

<sup>186</sup> Bogaert, *Banques et Banquiers*, above n 48 at 340–41, particularly text at n 206.

<sup>187</sup> See below, paragraph preceding and paragraph containing n 189.

As well, in connection with a cheque, there is the added risk of mere reliance by the banker on its presentment by the alleged payee of what would later be proved to be a falsified document not emanating from the bank customer. Stated otherwise, in contrast to the issue of a payment order to a bank directly by its customer, in connection with the presentment of a cheque by an unknown payee, the bank does not have any control of or advance knowledge on the 'communication route'; the bank cannot rely on either the customer's presence or delivery by a reliable agent of that customer.

To that end, Bogaert asserts that, to reduce cheque falsification risks, the operation of the cheque system in the Ancient World was premised on the issue of two documents by the payer. One is the 'authentic' cheque itself, issued by the payer to the payee, and the other is an advice, or 'control note', issued by the payer to his banker, alerting him to the forthcoming presentment of the cheque by the payee. Under this scheme, the operative payment order was the cheque itself, issued by the payer to the payee, who was to present it to the payer's bank; the document issued by the payer to his bank was a mere advice or alert; by itself it did not require any action on the part of the bank.<sup>188</sup> In Bogaert's view, the Florida collection is an assortment of such advice documents, and not of the cheques themselves. In his mind, this explains the brevity of the documents, their use of abbreviations (including in the names of the payees), as well as the incomplete information contained therein, by comparison to other texts of payment orders available from the same era. In short, the Florida collection testifies to the existence of a cheque system; yet, it does not contain the cheques themselves.

Bogaert's theory appears to have been confirmed in 1980 with the publication of the Berlin collection. The latter consists of 16 orders of payment. They all originated from the same mummy cartonnage in Abusir el-Melek from which documents of the Florida collection originated. These orders are dated from 82 BCE, namely very shortly after the last Florida document, so as also to belong to the Ptolemaic era. They are addressed to directors of royal banks rather than to private bankers. By comparison to those in Florida, the Berlin documents are of smaller amounts and yet are substantially more detailed; most names, and all those of the payees, are given in full; documents may give further details as to payee identification, such as family proximity or profession. As well, reason or object of payment is specifically indicated. Some documents are cancelled by crossed lines. In Bogaert's view, the Berlin documents are certainly authentic cheques, issued to payees; unlike the Florida counterparts, they are not mere 'control notes' or advice notes sent to banks.

<sup>188</sup> It is interesting to compare that ancient practice to the positive-pay procedure of the late twentieth century CE, under which, prior to payment of cheques purporting to be drawn by them and presented for payment, corporate customers confirm to banks electronically the authenticity of the cheque. For this practice in the USA see Subcommittee on Payments of the Uniform Commercial Code Committee, *Model Positive Pay Services Agreement and Commentary* (Chicago, Business Law Section of the American Bar Association, 1999). Certainly this electronic advice, professing to be on the 'cutting edge' of technological innovation, is a variation on the 'control note' of Ptolemaic Egypt of 2,000 years earlier.

It may well be that during both the Ptolemaic and Roman periods, a payee of a payment order, whether or not a cheque, rather than receiving payment in cash at the payer's bank, could have instructed the payer's bank to make the payment into the payee's account with the payee's own bank. This mechanism could have worked only where the payer's bank kept funds in an account maintained by the payee's bank, namely, where the two banks were correspondents. The payee's order issued to the payer's bank would have been executed by means of a cheque drawn by the payer's bank, issued to the payee, and instructing the payee's bank to make the requested payment. The payee would then have presented that cheque to his own bank, on which the cheque was drawn. That bank would then have carried out payment by debiting the account of the payer's bank and crediting that of the payee. The process of payment of the 'bank draft' was like that of any other cheque; in fact, a 'control note' issued by the payer's bank to that of the payee was published together with the Berlin collection.

Being drawn by one banker on another, the cheque issued by the payer's bank was the forerunner of a bank draft or money order.<sup>189</sup> Its underlying mechanism was premised on the existence of bilateral inter-bank correspondent relationship; according to Bogaert, there is evidence of the existence of such relationships during both the Ptolemaic and Roman periods, and even between banks of different categories, as for example, a royal and a leased bank. At the same time, no inter-bank multilateral arrangements surfaced in Greco-Roman Egypt.

Today's typical cheque collection mechanism can operate either on a bilateral or multilateral basis. Either way, as discussed below in chapter ten, the mechanism originated in the post-Medieval era in England. Under the classification of payment mechanisms in chapter one, section 4.1 (ii) above, the modern cheque collection is a 'debit pull' mechanism, in which the payee instructs his own bank to *collect* funds from the payer's bank.<sup>190</sup> In contrast, in Antiquity, the payee instructed the payer's bank to *forward* funds to the payee's bank as to generate a 'credit push' mechanism. In the process, a nascent bilateral inter-bank payment system involving the use of bank drafts came into existence.

Nowadays, albeit infrequently, the payer's banker may pay a cheque presented to him by a non-customer payee 'over the counter', namely in cash, and not through the interbank cheque collection system, in a banking process initiated by the payee's bank. Indeed, the presently known method of payment in cash 'over the counter' has its origins in the standard manner for paying a cheque in Antiquity. However, in the final analysis, the Ptolemaic cheque system was

<sup>189</sup> For legal aspects of these instruments under modern law see eg B Geva, 'Irrevocability of Bank Drafts, Certified Cheques and Money Orders' (1986), 65 *Canadian Bar Review* 107.

<sup>190</sup> In fact, at present, also the application for the payment of an 'on-us' cheque presented for payment by the payee at the bank – or even branch – where both he and the payer hold their respective bank accounts is also that of 'debit transfer', in the sense that the banking operation commences with the provisional credit posted to the payee's account. See *Capital Associates Ltd v Royal Bank of Canada* (1970) 15 DLR (3d) 234 (Que. SC), aff'd (1973) 36 DLR (ed) Que. CA), (1976) 65 DLR (3d) 384 (SCC).

premised on a self-defeating process and therefore was doomed. As was indicated, the advantage of a cheque system is the facilitation of the flow of payment by bypassing the separate communication from the payer to his bank; for its part, the 'control note' system necessitated this communication. Thus, the cheque system in Ptolemaic Egypt required the issue by the payer of both the cheque to the payee, and the 'control note' to the payer's banker. Thus, in not bypassing the direct communication from the payer to his bank, the Ptolemaic cheque system carried the seeds of its own demise.

To sum up, as indicated, Greco-Roman Egypt is reputed to excel with various types of banking institutions, extensive bank networks and diverse banking operations. At the same time, in assessing the progress made, it is important clearly to distinguish between myth and reality. A few points must therefore be stressed. First, by way of regression, in departure from their Greek and Roman predecessors, banks in Greco-Roman Egypt scarcely acted as lenders; rather, they acted as brokers facilitating lending made by their depositors to borrowers. Strictly speaking then, they were deposit taking institutions, in the literal sense of the term, and not 'banks'. They brokered lending but did not lend. Second, in line with both the Greek and Roman banking systems, no multilateral interbank clearing arrangements manifested themselves in Roman Egypt. Third, no nationwide giro system, accommodating cashless payments throughout the entire country, appears to have existed. Nationwide State banking served as a basis for centralized treasury operations for the Government rather than as the foundation for a countrywide integrated payment system. Indeed, it may well be that it is this treasury function that facilitated the survival of banks in Egypt; and while private banks did not provide treasury functions, they managed to survive alongside the public banks, even without acting as lenders in their own name and right.

Fourth, it may well be that, in terms of the broad economic picture, and taking into account the lack of continuity in the documentary record, the historic importance of the Greco-Roman non-transferable cheque in Egypt is overstated.<sup>191</sup> However, in connection with the search for the origins of facilities for payment through banks by means of the execution of payment orders, the cheque may well be singled out as a principal contribution of Greco-Roman Egyptian banking. Particularly noteworthy is the birth of the cheque in a context in which different payment mechanisms, designed to meet diverse and specific needs, developed in a banking system that, so far as Antiquity is concerned, was quite advanced. Being a payment instrument issued by the payer directly to the payee, the cheque certainly contributed to the enhancement of the flow of a payment transaction. The cheque is a further reflection of the growth and increased diversification of the Greco-Roman Egyptian credit system.<sup>192</sup>

<sup>191</sup> A point made by Andreau, *Banking*, above n 55 at 43.

<sup>192</sup> See eg Gabrielsen, 'Banking and Credit Operations in Hellenistic Times', above n 146 at 140, referring to the use of non-transmissible cheques in 'late Hellenistic and Roman Egypt' as 'a further refinement of the practice of "order of payment through a bank"', or more specifically, 'a procedure that eased credit extension within the business community'.

Having emerged as a payment system in Ptolemaic Egypt during the first half of the first century BCE, the cheque nevertheless appears to have been eclipsed in the course of the Roman period.<sup>193</sup> As will be discussed below in chapters eight and ten, the cheque resurfaced only in the late Middle Ages in Continental Europe; later, in the seventeenth century CE, the cheque spread its roots and grew to generate a 'cheque system' as far away as in England.

## 6. SUMMARY

Ancient Mesopotamia has been identified as the cradle of banking operations. It earned this title due to the emergence of institutions providing all core banking activities, namely, deposit taking, lending and payment services. However, this was a secondary activity for such institutions; moreover, credit was made available by depositaries out of their own capital and without dipping into deposits, so that deposit taking had not turned yet into banking. Thus, the emergence of banking operations in Ancient Mesopotamia led to neither the emergence of banking, in the full sense of the word, nor to the appearance of banks as distinct institutions.

However, even prior to the emergence of 'monetized' coins, we see the provision of nascent payment services in Ancient Mesopotamia in the form of third-party withdrawals in kind or specie, particularly from a depositor's account, carried out by depositaries pursuant to the depositor's instructions. However, there appears to be no evidence for the execution of non-cash payments from one account to another and there is no trace of inter-institutional clearing and settlement.

If Ancient Mesopotamia was the cradle of banking operations, the emergence of the bank as a distinct type of institution carrying out 'banking', namely financial intermediation between depositors of funds and borrowers of those funds, took place in Ancient Greece. Thus, the invention of money gave rise to the moneychanger who gradually turned banker; in this capacity he allowed his depositors to make withdrawals as well as to make and receive payments, in pursuance of money orders. A money order was issued to the banker; it could have been executed by means of posting debit to the payer's account and credit to the payee's account with the same banker, but was usually carried out by payment in cash. In connection with such bank payments, basic documentation, as well as nascent interbank bilateral correspondent relationships emerged; and yet, no multilateral interbank, whether intracity or inter-city, emerged.

By reference to institutions and facilities known earlier to the Greeks, no major progress could be noted in the Roman World. Certainly, compared to classic Greece, the institutional scene in Rome was more complex; and yet, this complexity did not lead to advancement in bank practices. In fact, with respect

<sup>193</sup> For a reference to a cheque from the Roman period (year 125 CE) see n 183 above.

to the development of standard documentation and terminology, the reverse is true; richer technical vocabulary and more sophisticated standard terminology are said to have existed in classic Greece, not to mention the Hellenistic World.

Nevertheless, compared to Ancient Greece, lack of major progress in Roman banking practice is not without noteworthy exceptions and any statement to that effect must thus be qualified. In two major respects Roman banking practice went beyond that of the Greek. First, the receiver-banker could be treated as the first money transmitter. However, money transmission by a receiver-banker may have developed under narrow circumstances, in the context of auctions, and in any event did not extend to cover payment between distant parties. Second, nascent interbank correspondent arrangements, under which one bank held funds in an account with the other, developed; particularly, this facilitated payments between distant parties. A non-cash payment could have been carried out between accounts of two depositors, either in the same bank, or in two banks situated in the same small town or within a specific market, whether permanent or periodic. And yet there was neither an inter-city nor intracity multi-lateral interbank clearing and settlement system.

For its part, Greco-Roman Egypt is reputed to have excelled with various types of banking institutions, extensive bank networks and diverse banking operations. However, in assessing the progress made, it is important clearly to distinguish between myth and reality. Two points are thus to be stressed. First, by way of regression, in departure from their Greek and Roman predecessors, banks in Greco-Roman Egypt scarcely acted as lenders; rather, they acted as brokers facilitating lending made by their depositors to borrowers. Second, no nationwide giro system, accommodating cashless payments throughout the entire country, appears to have existed. To that end, Davies' observation that in contrast to Egypt, 'no centralized state giro system developed in the Roman empire',<sup>194</sup> seems to be drawn on research on banks in Greco-Roman Egypt that preceded, and was superseded by, that of Bogaert.<sup>195</sup> Davies' observation thus appears to be founded on shaky premises; absence in Rome was consistent with the situation in Alexandria and not in contrast to it. As a matter of fact, the country-wide granary system that was said to give rise to grain warehouse banking in Egypt did not replicate itself in 'money banking'. The 'unified state banking system' in Egypt to which Davies refers<sup>196</sup> provided a basis for government centralized treasury operations, which may explain both the robustness of the banking system and even the survival of banks in Egypt; nevertheless, that system did not provide for a nationwide integrated payment system for individuals and businesses.

<sup>194</sup> Davies, above n 15 at 92.

<sup>195</sup> In terms of relations among banks and hence, the resulting method of deposit account management, earlier research, discussed by Bogaert in 'Le Statut des Banques en Égypte Ptolémaïque' (1981), *Trapezitica*, above n 129 at 47, envisaged State banking to be more centralized than subsequently found by Bogaert himself. See text at n 161 above.

<sup>196</sup> Davies, above n 15 at 92.

At the same time, so far as orders to pay money and the payment system are concerned, a principal contribution of Greco-Roman Egyptian banking is arguably the cheque. Having emerged as a payment system in Ptolemaic Egypt during the first half of the first century BCE, the cheque nevertheless appears to have been eclipsed in the course of the Roman period. As will be discussed below in chapters eight and ten, the cheque resurfaced only in the late Middle Ages in Continental Europe; later, in the seventeenth century CE, it spread its roots and grew to generate a 'cheque system' as far away as in England.

In sum, so far as orders to pay and the payment system are concerned, other than cash, Antiquity thus gave rise to the bank, to the payment order including the cheque, as well as to bilateral interbank correspondent relationships. Modest steps forward were made towards the emergence of standard documents and procedures; at the same time, no nascent multilateral interbank relationships appear to have surfaced.

## Deriving History from Law: Are Cheques Traceable to the Talmud?

|                                                                            |     |
|----------------------------------------------------------------------------|-----|
| 1. Introduction                                                            | 158 |
| 2. Directing a Creditor to a Paymaster: The <i>Bava Metzia</i> Text        | 161 |
| 2.1 The Talmudic Text in <i>Bava Metzia</i> : Credit Extended by Paymaster | 161 |
| 2.2 Tosafot's Commentary – Renunciation of Recourse                        | 165 |
| 2.3 Other Commentators – Elaborating Tosafot's Discussion                  | 172 |
| 2.4 Which Scenario? – Aspects of Tosafot's Analysis Revisited              | 176 |
| 2.5 Talmudic Text in <i>Shevuot</i> – Tosafot's Position Supported         | 178 |
| 3. Final Modern Lawyer's Observations                                      | 184 |
| Appendix: Glossary of Post-Talmudic Jewish Law Sources                     | 186 |

### 1. INTRODUCTION

EMINENT HISTORIANS SINGLE out the Talmud<sup>1</sup> as being a unique legal text in Antiquity providing for a framework facilitating at least a limited cheque system.<sup>2</sup> However, the Talmud does not provide for ade-

<sup>1</sup> The Talmud is the summary of the oral law that evolved after centuries of post-biblical scholarly effort by the Jewish sages who lived in Eretz-Yisrael (Palestine, being biblical Canaan, or Judea as it was until shortly after the turn of the Common Era (CE)) and Babylonia. It has two complementary components; the Mishna, a book of law, and the extensive commentary, in the form of an edited record of the discussions in the academies, known as Gemara. In principle, each Mishnaic law is followed by the corresponding Gemara commentary, so that both form the Talmudic text on a given point. The compilation of the Mishna was completed in Eretz-Yisrael around 200 CE. A contemporary source not included in the Mishna but nevertheless reproduced and discussed in the Gemara is called a Beraitha. There are two versions of the Gemara; the one whose compilation was completed in Babylonia in the fifth century CE ('Talmud Bavli') is the more authoritative version. The compilation of the other version, known as the Jerusalem Talmud ('Talmud Yerushalmi') was completed in Eretz-Yisrael in the fourth century CE. For an introduction, see eg A Steinsaltz, *The Talmud—The Steinsaltz Edition – A Reference Guide* (New York: Random House, 1989) (hereafter: Steinsaltz, *The Talmud: A Reference Guide*). According to A Steinsaltz, *The Essential Talmud* (New York: Basic Books, 1976) at 3: 'If the Bible is the cornerstone of Judaism, then the Talmud is its central pillar.' Other than where indicated otherwise, the ensuing discussion (in this chapter and elsewhere in the book) is on the basis of the Hebrew-Aramaic original text of the Talmud Bavli. English translation and comprehensive commentary is published by Mesorah Publications Limited, the Artscroll Series/Schottenstein Edition. Unless specifically indicated otherwise, all Jewish law sources cited and discussed in this book are in Hebrew (or Hebrew-Aramaic).

<sup>2</sup> See eg R Bogaert, *Banques et Banquiers dans les Cités Grecques* (Leyde: AW Sijthoff, 1968) at 340–41, fn 206, and 413, fn 7 and Bogaert's speech in a conference session reproduced in (1977), 123



quate legal infrastructure for banking to develop; it prohibits the taking of interest on loans,<sup>3</sup> and further inhibits the lending out of deposits.<sup>4</sup> Banking is premised on lending out of bank deposits for profit, and it is against the background of a thriving banking system that one expects the development of a cheque, or in fact any non-cash payment system.<sup>5</sup> Hence, the existence of a Talmudic cheque system is counter-intuitive.

Certainly, a plain reading of a relevant Talmudic text may point to the possible existence of a cheque system. Nevertheless, a rigorous analysis of this text, supported by traditional scholarly commentaries, leads to a contrary conclusion. Based on a study of the text and commentary, the present chapter makes the following arguments:

1. While written legal documents are recognized by the Talmud,<sup>6</sup> there is no indication supporting the existence of written cheques; at the most, the alleged cheque system was oral. True, a cheque need not necessarily be circulating, and it is easier to envisage an oral non-circulating cheque than an oral circulating cheque. However, lack of embodiment in paper is inconsistent with standardization required for a 'system' to exist.<sup>7</sup>

*Revue Belge de Numismatique et de Sigillographie* 265, where he speaks of the cheque under the Talmud as an instrument of payment to workers who, according to Mosaic laws, are to receive their wages daily. To a similar effect see also J Andraeu, *La Vie Financière dans le Monde Romain: Les Métiers de Manieurs d'Argent* (Rome: Ecole Française de Rome Plais Farnèse, 1987) at 562; and J Andraeu, *Banking and Business in the Roman World*, trans by J Lloyd (Cambridge: Cambridge University Press, 1999) at 42, where he states that 'the use of cheques is attested . . . in Canaan, following rulings made by Mosaic laws on the payment of wages.' See also E Ashtor, 'Banking Instruments Between the Muslim East and the Christian West' (1972) 1 *Journal of European Economic History* 553 and reprinted (with same pagination) in BZ Kedar (ed), *East-West Trade in the Medieval Mediterranean* (London: Variorum Reprints, 1986) 553 at 555.

<sup>3</sup> Prohibition is based on three biblical cites and exists for any transaction where a party is obligated to deliver or pay in genre. These biblical verses are Exodus 22:24, Leviticus 25:36–7, and Deuteronomy 23:20. R Bogaert, *Les Origines Antiques de la Banque de Dépôt* (Leyde: AW Sijthoff, 1966) (hereafter: Bogaert, *Les Origines*) at 157 acknowledges this factor as one that militated against the development of banking among the Jews in Judea during the period under discussion.

<sup>4</sup> The principal text is Talmud, *Bava Metzia* at 43A *et seq.* It gives the moneychanger a limited right to use money deposited in an open bag but not to mix the entire deposit with others. See below, section 2.1. Certainly, if so agreed, and for a fee, the moneychanger could invest money deposited with him, either for a depositor or even under a joint venture with him, though in the latter case, only under a mutual profit and loss sharing agreement. See Talmud, *Bava Metzia*, at 68a and 104b.

<sup>5</sup> For the link among these three activities, namely, deposit taking, lending, and the provision of payment services as underlying the origin of banking in Ancient Greece, see Bogaert, *Les Origines*, above n 3 at 137–44. Now as then, '[t]o be recognized as a bank . . . an institution is expected to receive deposits of money from its customers; to maintain current accounts for them; to provide advances in the form of loans or overdrafts; and to manage payments on behalf of its customers'. See eg E Green, *Banking – An Illustrated History* (New York: Rizzoli, 1989) at 11.

<sup>6</sup> See eg Talmud, *Kiddushin* at 47B–48A (documentary debt) and Talmud, *Bava Kamma* at 70A (the *urcheita*, being a written and properly witnessed authorization given by a creditor to an emissary, turning him into an agent with the power to collect from the creditor's debtor money or chattel owed by that debtor to his creditor). Both documents are discussed below in ch 7 in sections 2.2 and 2.3 respectively.

<sup>7</sup> Contrast with the system for non-circulating and yet written cheques in Greco-Roman Egypt set out in RS Bagnall and R Bogaert, 'Orders for Payment from a Banker's Archive: Papyri in the Collection of Florida State University' (1975) in R Bogaert, *Trapezitika Aegyptiaca, Recueil de*

2. While a cheque may be drawn against a line of credit, a cheque system is typically associated with funds kept with depositaries, which are withdrawn by cheque.<sup>8</sup> However, the Talmudic discussion on the closest scenario to a cheque system is taken to relate to a situation in which the paymaster extends credit to the debtor.
3. Presence of all three parties may be required for the renunciation of recourse by a creditor against the debtor to whom a paymaster extends credit. Presence of all three is, however, ill-suited to accommodate the cheque mechanism, under which a cheque is issued by the debtor to the creditor, and subsequently presented by the creditor to the paymaster, without all three being present at the same time in the same place.
4. By comparison to contemporary legal systems, the Talmudic analysis on the subject is quite sophisticated. Furthermore, it led to a discussion that foresaw interesting forthcoming issues underlying the modern cheque. Nevertheless, the law that evolved in the Talmud to govern the situation under discussion is inadequate to provide for a comprehensive satisfactory scheme covering cheques. This would be atypical in light of the thorough and meticulous analysis of the scenario by the relevant Talmudic text. Hence, it is not a cheque scenario that is analysed in that text.

The main part of the chapter is an in-depth analysis of the Talmudic passage and related commentaries from which the existence of the cheque is said to derive. The chapter develops the above-mentioned arguments and concludes against the existence of cheques and a cheque system under the Talmud. However, I recognize that the passage, in conjunction with related commentaries may have foreseen interesting forthcoming issues that subsequently became relevant to the discussion of the modern cheque.

Traditional commentaries shedding light on the passage are of much later vintage than the Talmudic text. Roughly, they stretch from the early Middle Ages, shortly after the Talmud had been finalized, well into the nineteenth century CE. Modern scholarly work discussing the passage is also addressed in this chapter. Certainly, each analysis is likely to be influenced by legal concepts and terms of its own time. However, each of the commentaries mostly focuses on the Talmudic text itself, in its own context, rather than on its application to conditions and situations relevant to the period of the writing of the respective commentary. As such, these commentaries are valid sources for discussing the meaning of the Talmudic text for the period in which the Talmudic text was written.

*Recherches sur la Banque en Égypte Gréco-Romaine* (Florence: Edizioni Gonelli, 1994) 219 at 239; and R Bogaert, 'Note sur l'Emploi du Chèque dans l'Égypte Ptolémaïque' (1983) in *Trapezitica*, *ibid* at 245. See also R Bogaert, 'Recherches sur la Banque en Égypte Gréco-Romaine' (1987–89) in *Trapezitica*, *ibid* 1 at 23; and R Bogaert, 'Les Opérations des Banques de l' Égypte Ptolémaïque' (1998), 29 *Ancient Society* 45 at 141.

<sup>8</sup> In modern law the point is acknowledged in eg Art 3 of the *Uniform Law on Cheques* (adopted on 11 March 1931 by the Second Geneva Convention on Bills of Exchange, being *Convention Providing a Uniform Law for Cheques*, 19 March 1931, 143 L.N.T.S. 355, Annex I) effectively providing that a cheque is usually 'drawn on a banker holding funds at the disposal of the drawer'.

For the convenience of the reader, this chapter is followed by an appended glossary of Jewish law sources. The glossary, compiled on the basis of publicly available information, sets out each source alphabetically, points out its historical period, and provides an overview of each source. It is designed to assist the reader when used in conjunction with this chapter, section 2 of chapter two above, and chapter seven below.

## 2. DIRECTING A CREDITOR TO A PAYMASTER: THE *BAVA METZIA* TEXT

### 2.1 The Talmudic Text in *Bava Metzia*: Credit Extended by Paymaster

Biblical law requires an employer to pay wages that are due to a worker for labour on the day services were rendered.<sup>9</sup> In *Bava Metzia*, the Mishna presents some qualifications to the prohibition against delaying payment, one of which is the case where the employer directed the worker to receive payment from a storekeeper or moneychanger.<sup>10</sup> On this passage the Gemara asks whether the worker has recourse against the employer or not. One sage, Rav Shesheth, would not allow the recourse, while another sage, Rabbah, would permit it.<sup>11</sup>

For lack of discussion on the points, it is safe to assume that neither a pre-existing master agreement nor writing is required. Rashi says that the scenario dealt with by the Mishna is that of an employer directing to the storekeeper a worker who needs to purchase provisions, and in which the employer instructs the storekeeper to sell the provisions to the worker, against the employer's payment (or reimbursement) obligation. In this setting, the storekeeper does not pay the worker any amount previously deposited with him or otherwise owed by him to the employer; rather, he extends credit to the employer.

On the setting involving the moneychanger, Rashi is more equivocal; he states that the employer instructs the moneychanger to give the employer small-value coins for one large-value coin. This sounds like a money-change transaction; presumably the employer is to pay a large-value coin against the payment of wages to few workers, each receiving his own wages in small-value coins. This could be consistent with a simultaneous exchange in a money-change transaction, as well as with an advance payment by the employer to the moneychanger,

<sup>9</sup> Leviticus 19:13 (quoted in n 12 below). The Mishna, in Talmud, *Bava Metzia* at 111A, applies this same-day payment requirement also to the rental payment due from a hirer to an owner of a rented animal or utensils, so that the discussion below equally applies to the recourse from the hirer by an owner of a rented animal or utensils who is to be paid by a storekeeper or moneychanger.

<sup>10</sup> Talmud, *Bava Metzia* at 111A.

<sup>11</sup> Talmud, *Bava Metzia* at 112A. Both sages endeavour to rationalize their positions on the Mishnaic text itself. Thus, Rabbah asserts that in merely stating that the employer is released from the transgression of the prohibition against withholding payment, the Mishna is telling us that the employer is not released from the responsibility to pay the worker. Conversely, Rav Shesheth asserts that in stating that the employer is released from the transgression of the prohibition against withholding payment, the Mishna is telling us that the employer no longer has any financial obligation whatsoever.

or even with a deposit held by the moneychanger for the employer, out of which payment to the worker is to be made. It could however be equally consistent with the situation in which the employer is to pay the large-value coin to the moneychanger at a later date, which is not different from the employer's obligation to pay the storekeeper for the provisions sold to the worker. It is the symmetry between the position of the storekeeper and moneychanger which supports the conclusion that the moneychanger ought to be treated as being in the same situation as the storekeeper, so as to be regarded as extending credit.

Further possible indirect support to limiting the Talmudic text in *Bava Metzia* to the credit-extension scenario can be derived from the fact that in circumstances under which the text excuses the employer who delays payment, the employer is said not to have money 'with him'.<sup>12</sup> In this context, a contrary situation in which the employer has money 'with him', so as not to be excused, can narrowly, and admittedly inconclusively, be construed not to be limited to money in specie, namely, in the form of coins in the employer's possession; rather, it is to include even a situation in which money is owed to the employer under a loan or deposit. In such a case, having 'with him' money owed by the paymaster, the employer will not be covered by the Talmudic text in *Bava Metzia*, which is thus to be read as limited to a situation in which the paymaster does not owe money to the employer but rather extends credit to him.

In the situation depicted by Rashi, credit is extended by either the storekeeper or moneychanger in the form of actual payment, whether in kind or in money, and not in a form of a guarantee supporting the employer's undertaking to make such payment in the future. It is in this sense that the storekeeper or moneychanger acts in the *Bava Metzia* text as a paymaster and not as a surety.

Commentators made no distinction between scenarios involving a storekeeper or a moneychanger, and are taken to refer to both even when they only mention one; in the present discussion, 'paymaster' is thus used to refer to either a storekeeper or a moneychanger. Furthermore, **the credit extension interpretation has not been challenged by authoritative commentators**.<sup>13</sup> Indeed, the position of the storekeeper as extending credit,<sup>14</sup> particularly in selling provisions

<sup>12</sup> Leviticus 19:13 states in full as follows: 'You shall not retain what is due to your fellow, and you shall not rob; the wage of a hired worker shall not stay overnight *with you* until morning.' (Emphasis added.) 'With you' was understood as referring to withholding wages (i) against the will of the worker and contrary to his demand; (ii) where the employer has no money; and (iii) when the employer directed the worker to a paymaster. See Talmud, *Bava Metzia* at 112B.

<sup>13</sup> By 'authoritative commentators' I refer to those according to whom authorized ruling is promulgated in Jewish law. For a dissenting modern scholarly view on the point, drawn from historical parallels, see S Albeck, 'The Assignment of Debt in the Talmud' (1957), 26 *Tarbiz* 262 at 274–77 [in Hebrew], where he specifically rejects the view of the early commentators (at 277, fn39) and argues that the scenario in the *Bava Metzia* narrative is one in which the paymaster is instructed to pay out of the employer's deposit kept with him. Among the more recent commentators, cf Tur, *Choshen Mishpat*, Section 339, where the scenario is described as one that *even* covers the case where the paymaster owes nothing to the employer. Albeck's position is further dealt with below in nn 21, 23, and 40.

<sup>14</sup> See eg a general reference in Talmud, *Kiddushin* at 40A.

against deferred payment obligations,<sup>15</sup> is mentioned elsewhere in the Talmud. In turn, the position of the moneychanger who regularly deals in money matters,<sup>16</sup> also acting as a moneylender, is more obvious; elsewhere the Gemara refers to the employer who borrows from a moneychanger to pay the wages of his workers in the marketplace.<sup>17</sup> Presumably, in our scenario, by having the disbursement of the loan directly made to the worker, rather than to the employer who will then pay the worker, the employer may have saved on administration, at least by bypassing the need to deal with small-value coins to be paid to numerous workers.<sup>18</sup>

The conclusion that the paymaster extends credit to the employer may be drawn from the view that the *Bava Metzia* narrative is limited to a situation where all three are required to be present together.<sup>19</sup> This is so since in *Gitin*, the Gemara discusses the legal implications of an instruction directed to a person who owes money to the instruction giver, to make payment to a third person. In such a case, the presence of all three in one place is specifically required.<sup>20</sup> This would cover the case of the employer who directs a storekeeper or moneychanger who owes money to him to make payment to the employer's worker. Hence, where the presence of all three is required, a separate discussion may be needed only for the case of the employer who directs his worker to receive payment from a storekeeper or moneychanger who does not owe money to the employer.

Obviously, however, this does not prove the reverse, namely, that the presence of all three is required in the *Bava Metzia* setting. It could well be, indeed, that the consensus on viewing the paymaster as extending credit to the employer<sup>21</sup> is not premised on a requirement as to the presence of all three; rather it derives

<sup>15</sup> See eg discussion on the storekeeper concerning his ledger, Talmud, *Shevuot* at 45A and the Jerusalem Talmud, *Shevuot* at 36B (further dealt with in section 2.5 below), where nevertheless the storekeeper's books are not accorded great credibility. See particularly Pnei Moshe on the Gemara in the Jerusalem Talmud, *Shevuot* at 36B.

<sup>16</sup> See in general, A Gulak, 'The Moneychanger's Business According to Talmudic Law' (1931), 2 *Tarbitz* 154 [in Hebrew].

<sup>17</sup> Talmud, *Bava Metzia* at 46A.

<sup>18</sup> See second and third paragraphs in this section.

<sup>19</sup> On this point, see Rif on Talmud, *Bava Metzia* at 68A (of Rif's page numbering).

<sup>20</sup> Talmud, *Gitin* at 13B. This setting is further analysed below in ch 7, section 3.

<sup>21</sup> A modern departure from this consensus is by Albeck, 'The Assignment of Debt', above n 13. He assumes that the presence of all three is not required in the *Bava Metzia* narrative, but nevertheless argues that this text is concerned with the case where the paymaster owes the money to the employer. Albeck distinguishes between the *Bava Metzia* scenario and the one in *Gitin* (see particularly *ibid* at 276, fn 38), by saying that the former is concerned with a payment order, rather than the transfer of a debt owed by the paymaster, which is the concern in *Gitin*. In Albeck's view, in the *Bava Metzia* setting, upon assuming the employer's obligation to pay the worker his wages, the paymaster became subject to the requirement not to delay payment to the worker, and could not discharge himself by merely transferring to the worker the debt he (the paymaster) owes to the employer. But as will be seen below in n 40, there is a difficulty in theorizing the paymaster's liability to the worker, where the paymaster owed money to the employer. Nor does Albeck explain lack of immediate payment by the paymaster (who allegedly owes funds to the employer) or why the worker's consent to the alleged debt transfer does not excuse the prompt payment obligation, all of which is addressed in section 2.5 below (which further supports the presence of all three requirements).

from an understanding of the economic background. As indicated in the paragraph that follows, support for the conclusion that, as depositaries of money who owed money to their depositors, neither the moneychanger nor the storekeeper acted as paymasters, may come from elsewhere in the Talmud.

Certainly, the moneychanger was in the business of taking deposits of money, and perhaps the storekeeper followed suit.<sup>22</sup> Yet, there is no indication as to the economic function of the depositary as a paymaster.<sup>23</sup> Indeed, an important observation can be made with regard to the above-mentioned discussion in *Gitin*,<sup>24</sup> on the impact of an instruction given to a person who owes money to the instruction-giver to pay to a third party. The discussion is in general terms. It refers to the three individuals anonymously as 'Reuven, Shimon, and Levi'; it does not characterize them as employer, moneychanger or storekeeper, and worker, as in the scenario under discussion in *Bava Metzia*. Stated otherwise, in *Gitin*, the Gemara declines to refer to the depositary-paymaster as a moneychanger or storekeeper; rather, it treats the depositary-paymaster as an anonymous 'Shimon'. Thereby, it may tell us that as a paymaster, the moneychanger or storekeeper must have been taken to act as a credit extender and not a debtor to the instruction-giver.

In the final analysis, no firm conclusions can be drawn from the plain *Bava Metzia* text, which is quite equivocal as to whether it is envisaged that all three must be present. True, in his commentary, Rashi speaks of the employer as 'cutting off the worker from him and making him stand with the storekeeper';<sup>25</sup> there is no indication in Rashi's description of the employer physically joining the worker and the paymaster, so that all three are present together. Yet, this interpretation is inconclusive; Rashi may use his words metaphorically and simply refer to the employer-debtor's intention to sever the legal tie between him and the worker-creditor, and have it replaced by a new direct legal relationship between the paymaster and the worker-creditor.

A cheque may be drawn on a line of credit, though typically it is drawn on funds on deposit.<sup>26</sup> Even if tracing the early cheque to a mechanism premised on the extension of credit is not fatal to characterizing the mechanism as a cheque, it does not lend support to this characterization. At the same time, the presence

<sup>22</sup> See Talmud, *Bava Metzia* at 43A, discussed below in ch 7, section 2.1, where it is disputed as to whether, in terms of his permission to deal with deposited money and his responsibility for its loss, the storekeeper's position is that of the moneychanger or of a regular depositary. According to Gulak, above n 16 at 159, it may well be that moneychangers operated only in large cities, so that it was common for storekeepers to act as moneychangers in the villages. This view can be drawn, eg, from Rava in Talmud, *Bava Metzia* at 52B.

<sup>23</sup> With respect, I do not think sources put forward by Gulak, 'The Moneychanger's Business', above n 16 at 158–59; and Albeck, 'Assignment of Debt', above n 13 at 276–77, support their conclusions to the contrary. Commentators cited throughout this section have been of the view that relevant sources deal with the moneychanger or storekeeper extending credit and not owing money to the employer.

<sup>24</sup> Above n 20.

<sup>25</sup> Or in Hebrew, in English transliteration, '*Nitko me-ezlo ve-he-emidahu ezel chenваны*'.

<sup>26</sup> See above n 8.

of all three is certainly inconsistent with the cheque transaction flow, under which a cheque would be issued by the debtor/employer to the creditor/worker and subsequently presented for payment by the creditor/worker to the paymaster while not in the presence of the debtor/employer. Indeed, inasmuch as it specifically requires the presence of all three, the *Gitin* passage has not been viewed as dealing with a cheque. Discussion on whether all three are required to be present in the *Bava Metzia* passage is thus central to the thesis of this chapter; discussion on the point will however be deferred to section 2.5 below, when the legal underpinning of the disputation between Rav Shesheth and Rabbah, as well as other aspects of the factual scenario, are clarified. At this point, suffice it to say, in connection with the *Bava Metzia* narrative, that if the Talmudic text requires the presence of all three, a point to be revisited later, it must be taken to be limited to a scenario in which the paymaster is to extend credit rather than pay out of funds he holds for or owes to the employer.

## 2.2 Tosafot's Commentary – Renunciation of Recourse

Commentators' analysis revolves around the effectiveness of the renunciation of the worker's (creditor's) claim against the employer (debtor) so as to discharge the employer and disallow recourse by the worker against him. Two principal issues are addressed. The first is whether recourse is available also prior to, and irrespective of, the paymaster's default in payment. The second is the scope of the renunciation; here the discussion focuses on whether effective renunciation is conditional or absolute, whether it is express or implied, and whether its effectiveness depends on the paymaster's own obligation to pay. As well, discussion revolves around variations of the basic 'incomplete' scenario in our text.

There appears to be a preliminary disagreement as to the circumstances under which the employer-debtor who directed his worker-creditor to a paymaster is released from the duty to pay wages on time. Particularly, it is disputed whether the release works only where the worker agreed to look to the paymaster for payment.<sup>27</sup> However, it seems to me that this controversy does not apply to the case which gives rise to the worker's recourse. This is so since recourse is an issue to be raised where there has been a previous renunciation, which would have emerged in connection with the worker's consent to the direction.

Tosafot's commentary to the Gemara in *Bava Metzia*<sup>28</sup> contains a most comprehensive discussion on the recourse issue. It is however clear to Tosafot that any impact on the worker-creditor's recourse against the employer-debtor stems from the worker's consent to abide by the direction, or more specifically, from

<sup>27</sup> Contrast Kesef Mishna to Rambam, *Mishpatim: Hilchchot Schiruth*, Section 11, Rule 4, which requires worker's consent, and Beit Yoseph to the Tur, *Choshen Mishpat*, Section 339 which raises the possibility that worker's consent is not required.

<sup>28</sup> Talmud, *Bava Metzia* at 112A.



the renunciation embodied in this consent. The starting point for Tosafot is that the employer is liable to the worker to pay the latter's wages. The issue then is not recourse, which is obviously available to the worker against the party liable to him; rather, the issue is that of discharge, or loss of recourse, on the basis of the worker's renunciation. Hence, it is the scope of the renunciation, and its effect to generate either an absolute or conditional discharge, which preoccupies Tosafot's discussion.

It is clear to Tosafot that no disputation could arise where renunciation is accompanied by an act of *kinyan* (meaning a proprietary act). In such case, according to Tosafot, even Rabbah would agree that renunciation is effective to generate a discharge so that recourse has been lost. This is so under the general rule providing for the enforceability of agreements for which the serious intention has been manifested by an act of *kinyan*.<sup>29</sup> Moreover, in Tosafot's view, there is no disputation as to the effectiveness of a renunciation unaccompanied by an act of *kinyan*,<sup>30</sup> except that in such a case its scope and requirements have to be more carefully scrutinized. That is, on its own, and without any express words accompanying it, an act of *kinyan* would effect an absolute discharge;<sup>31</sup> at the same time, a 'bare' renunciation, unaccompanied by an act of *kinyan*, requires support, in language, circumstances, or both, to ascertain its validity and scope.<sup>32</sup>

Against this background, Tosafot first endeavours to determine the exact factual situation with respect to which the Gemara discussion takes place. He starts by ruling out two settings in which the answer, according to him, ought to be obvious, and hence ought not to give rise to any disputation. These are to be referred to below as Tosafot's two 'obvious' settings.<sup>33</sup> The first setting is where the worker, in agreeing to be paid by the paymaster, explicitly releases the employer, even in the case where the paymaster will not pay. **Each setting involves an express renunciation, albeit, of different scope.** The *first* setting is then a case of an unqualified renunciation, unequivocally stated. The *second* setting is that of a limited renunciation, namely, when the worker, in agreeing to be paid by the paymaster, explicitly makes the release or discharge of the employer contingent or conditional on actual payment by the paymaster. In

<sup>29</sup> '*Kinyan*' literally means property or acquisition. In Jewish law, as a *Halakhic* concept, an act of *kinyan* is a formal procedure to render an agreement legally binding. Acts of *kinyan* include pulling, transferring, controlling, lifting, or exchanging an article. See in general: Steinsaltz, *The Talmud: A Reference Guide*, above n 1 at 254. For a proprietary act for the transfer of ownership, see eg Talmud, *Kiddushin* at 22B, 25B–26A and *Kiddushin* at 25B and *Bava Batra* at 84B.

<sup>30</sup> Which is in line with Talmud, *Kiddushin* 16A, cited by Tosafot in Talmud, *Bava Metzia* 112A. Hereafter, 'Tosafot' is to mean Tosafot's editor.

<sup>31</sup> *Ibid.*

<sup>32</sup> To that end, an act of *kinyan* serves as an indication of firm resolution, without which an undertaking is not binding and is revocable; in the absence of such an act, the firm resolution is to be evidenced by other extrinsic circumstances. Cf S Albeck, *The Law of Property and Contract in the Talmud* (Jerusalem: Dvir, 1976, 1983) at 114–15 [in Hebrew]. The binding effect of a promise is the theme of B Lifshitz, *Promise: Obligation and Acquisition in Jewish Law* (Jerusalem: Ministry of Justice, 1988) [in Hebrew].

<sup>33</sup> Tosafot, D'H 'Hozzer' commenting on Talmud, *Bava Metzia* at 112A.



Tosafot's view, it is obvious that recourse is not available to the worker in the *first setting*, that of an express and absolute release of the employer by the worker; it is however equally obvious according to him that recourse is available, upon the default of the paymaster, in the *second setting*, that of an express release of the employer by the worker, stated to be conditional on the paymaster's default. In connection with both 'obvious' settings, the existence or absence of recourse is made dependent on the express terms of the worker's agreement to be paid by the paymaster.

Accepting the premise of a scenario involving the extension of credit by the paymaster to the employer, and adhering to his implicit assumption as to the centrality of the worker's consent to the direction by the employer, Tosafot then proceeds to lay down two alternative sub-scenarios in which the recourse controversy could arise.<sup>34</sup> The *first sub-scenario* is that of a worker who agrees to be paid by the paymaster, so as to indicate his reliance on the paymaster's undertaking to pay,<sup>35</sup> without expressly specifying to the employer whether the employer is thereby released, and if so, under what conditions, namely, whether the release, if any, is absolute or conditional. The *second, alternative, sub-scenario* laid down by Tosafot is that of an express renunciation by the worker of his recourse against the employer, on the condition of payment made by the paymaster.

The *first sub-scenario* is that of an absolute renunciation implied from the reliance on the paymaster. In discussing it, Tosafot is cognizant of the general rule that applies in the absence of a deposit or loan owed to the instruction-giver by the one who is instructed to pay to a designated payee. Then, the one who is instructed to pay may revoke his promise to pay the payee designated in the instruction; this is so even when such a promise was given in the presence of all three.<sup>36</sup> True, Tosafot concedes, this revocability rule appears to apply to the promise of the paymaster (the one who is instructed to pay); having agreed to pay the creditor-payee/worker, he is to extend credit to the debtor-employer/instruction-giver. Nevertheless, in the context of the first sub-scenario, and without necessarily limiting our scenario only to circumstances wherein all three are present in one location,<sup>37</sup> Tosafot rejects the application of this revocability rule. Rather, in Tosafot's view, an absolute release of the employer-debtor by the worker-creditor is possible in the context of the first sub-scenario when the paymaster assumes, towards the worker, a binding and irrevocable

<sup>34</sup> A third sub-scenario, under which the recourse does not relate to the underlying debt owed to the worker, but rather to the remedy for the violation of the prohibition against delaying payment, is not relevant to the present discussion and is thus not elaborated on here.

<sup>35</sup> In fact, it is not all that clear as to whether in this sub-scenario the worker is to expressly advise the employer of his exclusive reliance on the paymaster. In my view, Tosafot's analysis of this scenario also applies to the case in which the worker agreed to go to the paymaster without specifically stating that he relies on the paymaster.

<sup>36</sup> Talmud, *Gitin* at 13B. See ch 7, section 3 below.

<sup>37</sup> This is so since Tosafot specifically speaks of the revocability of the paymaster's promise *even* (and not only) when given in the presence of all three.

obligation, guaranteeing that of the employer; at that point, the paymaster is taken to advise the worker to rely entirely on him and release the employer. It is on the basis of this guarantee that the worker's statement, expressly made to the employer as to the worker's own reliance on the paymaster, is taken to implicitly renounce the worker's recourse right against the employer.

Tosafot is however unclear as to the language required to generate an implied paymaster's guarantee. Rather, he uses a word<sup>38</sup> that could mean either that the paymaster caused the worker to be next or close to him, or that the paymaster caused the worker to rely upon him. Having caused the worker to do so, the paymaster became 'as if saying' to the worker 'rely on me and release the employer'.

Both the binding effect of an oral guarantee, unsupported by an act of *kin-yan*, and the absolute discharge it may confer on the employer, are derived from discussions elsewhere in the Talmud.<sup>39</sup> First, the Talmud considers the satisfaction derived by the guarantor from seeing he is deemed by the creditor to be trustworthy as adequate to produce the guarantor's binding commitment.<sup>40</sup>

Second, under the Talmud, an ordinary guarantor is secondarily liable; he is answerable to the creditor only where the creditor is unable to collect from the principal debtor. To that end, the giving of the guarantee does not usually release the principal debtor from his primary liability; yet, there are exceptions to this rule.<sup>41</sup> Among those listed, the one exception in which the debtor is completely discharged<sup>42</sup> is where the guarantor is '*no-sé ve-noten ba-yad*', in which case the guarantor physically took the money from the lender and passed it on to the debtor. In such a case, the guarantor is regarded as the principal debtor, and the borrower receives an absolute discharge; in fact, he has never been even liable to the lender, but rather only to the guarantor.<sup>43</sup> Indeed, the basis for the

<sup>38</sup> In Hebrew, in English transliteration, '*bis-mi-cho*'.

<sup>39</sup> Talmud, *Bava Batra* at 173A–174A. For enforcement rights against the guarantor (which may be more extensive than those against the principal debtor), see Talmud, *Bava Metzia* at 115A.

<sup>40</sup> See the statement by Rav Ashi in Talmud, *Bava Batra* at 173B. This, however, falls short of rationalizing the effectiveness of an implied (as opposed to express) guarantee, as undertaken by the paymaster in our case. In any event, no similar satisfaction can be derived where the debtor already owes the guaranteed sum to the creditor, such as when, notwithstanding Albeck, 'Assignment of Debt', above n 13 as discussed in nn 13, 21, and 23, the paymaster owed the sum to the employer. The satisfaction derived by the paymaster in our scenario is discussed in the paragraph that follows the next one. For the impact of satisfaction as a mode of either acquisition or binding obligation see Y Friedman, 'Satisfaction and Property in the Talmud' (5732/1972), 3 *Dinney Yisrael* 115 [in Hebrew]. For the binding effect of a guarantee on the basis of satisfaction, in light of the apparent non-binding effect of a bare promise, see comprehensive discussion by Lifshitz, above n 32, at 1–117 (ch 1 dealing with promise) and 187–279 (ch 3 dealing with the guarantee).

<sup>41</sup> Talmud, *Bava Batra* at 173A–174A.

<sup>42</sup> Other exceptions affect the sequence of recovery, namely, cover circumstances in which the creditor may or is to recover first from the guarantor, rather than from the debtor, who nevertheless remains liable.

<sup>43</sup> The five categories into which a guarantee may fall are explained by Tosafot in Talmud, *Bava Batra* at 173B. The category under which the guarantor becomes a primary debtor and the principal (original) debtor is fully discharged is that of a '*no-sé ve-noten ba-yad*', literally translated as 'carries [the money from the lender] and gives [it] by hand [to the borrower]'. For a more detailed definition of '*no-sé ve-noten ba-yad*' see B Kahana, *Guarantee* (Jerusalem: Moresheet Hamishpat

primary nature of the paymaster's guarantee undertaking, has not been discussed by commentators. Presumably, however, what Tosafot can be taken to mean is that in our case, the paymaster is to be regarded *as if* he took money from the worker in order to pass it on to the employer, who had never been liable directly to the worker.

There is however another possible interpretation of Tosafot's analysis. The position of a guarantor who, for all intents and purposes, replaces the debtor who was originally liable to the creditor, is in fact addressed in the sources. Admittedly, the position of such a guarantor is mentioned elsewhere, and almost in passing. The context is that of a guarantee given by a Jew for the repayment of an interest-bearing loan taken by a Jewish borrower from a non-Jew. The guarantee is called '*shlof-dotz*' ('detach and attach'); having *detached* himself from the Jewish debtor, the non-Jewish creditor, *attaches* himself to the Jewish guarantor.<sup>43.1</sup> The replacing guarantee absolves the Jewish debtor from liability towards the non-Jewish creditor on the interest-bearing loan; but having been 'detached' from the creditor, the Jewish debtor becomes 'attached' to the Jewish guarantor, so as to be liable to him on an interest-bearing loan. Under Jewish law, interest is forbidden on a debt owed by one Jew to another but not on a debt owed between a Jew and non-Jew. Insofar as it transforms a lawful obligation (on an interest-bearing debt owed to a non-Jew) into an unlawful one (on an interest-bearing debt owed to a Jew), the '*shlof-dotz*' guarantee is prohibited<sup>43.2</sup> However, in my view, there is nothing to prevent a valid '*shlof-dotz*' guarantee from applying to a non-interest bearing loan and, as such, from applying also to a transaction in which all participants are Jews. Thus, perhaps, what Tosafot can be taken to mean is that, in our case, the paymaster becomes a

Be-Yisrael, 1991) at 95–101 [in Hebrew]. Tosafot points out that even in such a case, the borrower-principal debtor, who remains liable to the guarantor (who is liable to the lender-creditor), may find himself liable directly to the lender-creditor, though only in circumstances under which the guarantor cannot pay the lender-creditor; this could happen under what is known as 'Rabbi Nathan's lien' (see eg Talmud, *Pesachim* at 31A, *Ketuvot* at 19A, *Gitin* at 37A, and *Kiddushin* at 15A). That lien applies where A owes to B who owes to C, in which case C may recover directly from A, but only where he (C) cannot collect from B. Yet, this is a matter of enforcement by C (creditor-worker) of the debt owed to him by B (the paymaster-guarantor) by resorting to the security of the debt owed by A (the employer-principal debtor) to B (the paymaster-guarantor); by itself this is not a matter of A (the employer-principal debtor) being directly liable to C (the creditor-worker). For this nature of 'Rabbi Nathan's lien' see Rambam, *Mishpatim: Hilchchot Malvé ve-Lové*, Section 2, Rule 6; and Shulchan Aruch, *Chosen Mishpat*, Section 86, Rule 2.

<sup>43.1</sup> See Kahana, *ibid* at 92–93. For the origins of the expression, see Rashi in Talmud, *Yevamot* 109B D'H 'Shalzion'. The Gemara in Talmud, *Bava Metzia* at 71B (in conjunction with Rashi, D'H 'Azil') effectively understands non-Jewish guarantee law to be same as the '*shlof-dotz*' guarantee under Jewish law so as to absolve the debtor from liability towards the creditor and confer on the creditor a recourse only against the guarantor.

<sup>43.2</sup> Talmud, *Bava Metzia* at 71B. Prohibitions against charging, taking and paying interest in transactions between Jews are based on three biblical cites: Exodus 22:24, Leviticus 25:36–7, and Deuteronomy 23:20. Under an ordinary (and contrary to a '*shlof-dotz*') guarantee, a Jewish guarantor who was forced to repay a non-Jewish creditor an interest-bearing loan the latter had given a Jewish debtor, claims reimbursement from the Jewish debtor; he is not enforcing an interest-bearing loan and is thus not in violation of the interest prohibition.

‘*shlof-dotz*’ guarantor who replaces the employer-debtor as the party liable to the worker-creditor.

As a guarantor who is either ‘*no-sé ve-noten ba-yad*’ or ‘*shlof-dotz*’, the paymaster’s obligation is primary; it is neither secondary nor dependent on a co-extensive principal obligation of the employer.<sup>43.3</sup>

In effect, the dispensation with an act of *kinyan* (meaning a proprietary act) to support the irrevocability of the guarantee obligation appears to be consistent with the absolute discharge of the employer in the particular case of a guarantee given by the paymaster. Thus, in the usual case of a guarantee given for a loan, the binding effect of the guarantee is on the basis of the guarantor’s satisfaction derived from the reliance on him, so as to dispense with the *kinyan* requirement.<sup>43.4</sup> On its own terms this rationale is limited to circumstances where the guarantee was given prior to the disbursement of funds to the borrower by the lender;<sup>44</sup> in such a case, the disbursement of funds is the act done in reliance on the guarantee, which thus gives the guarantor the required satisfaction. In contrast, when the guarantee is given after the loan was disbursed, it cannot be said that the giving of the loan was on the basis of the guarantee, so as to give the guarantor the required satisfaction.

Therefore, the broad principle is that for a guarantee to bind without an act of *kinyan*, the guarantor is to derive satisfaction from ‘something’ done, or omitted to be done, by the creditor in reliance on the guarantee. In our scenario, the debtor-employer is to be seen as already owing the debt to the creditor-worker; he also risks violation of the prohibition against delaying wages to the worker; hence, there is no satisfaction derived by the guarantor-paymaster other than from seeing that, on the basis of his guarantee, the worker-creditor is releasing the debtor-employer, who is consequently positioned so as not to violate the prohibition against delaying payment.<sup>45</sup> To that end, the absolute discharge of, or loss of recourse against, the employer by the worker is the ‘something’ happening on the basis of the paymaster’s guarantee, so as to give him the satisfaction which dispenses the act of *kinyan*.<sup>46</sup>

<sup>43.3</sup> Which is the case for an ordinary guarantee. See Talmud, *Bava Batra* at 173B and Tosafot, above n 43. However, the primary obligation is not necessarily autonomous, namely free of defences available to the employer against the worker; it does not follow from the primary nature of the paymaster’s obligation that the paymaster is liable even if the worker has not performed under his contract of employment. Stated otherwise, it may nevertheless be an obligation to pay against the worker’s performance to the employer.

<sup>43.4</sup> Above n 40 per Rav Ashi.

<sup>44</sup> Talmud, *Bava Batra* at 176B.

<sup>45</sup> Even where the guarantee is given prior to the tasks to be performed by the worker under his contract of employment, as speculated below in section 2.5 in the text around n 78, it may be far fetched to suppose that as a general rule the worker (creditor) agreed to work for the employer (debtor) only in reliance on the paymaster’s guarantee, so as to give the paymaster the required satisfaction.

<sup>46</sup> Granted, any impact on the worker’s recourse from the employer on the basis of the paymaster’s guarantee, even short of total loss of recourse, would have given the guarantor-paymaster the required satisfaction. Eg, conditional discharge, effectively reversing the sequence of liability, so as to allow or require the creditor-worker first to attempt to recover from the guarantor-paymaster,

As mentioned above, the disputation between Rav Shesheth and Rabbah is on the continued liability of the employer. According to Rav Shesheth, no recourse is available; thus, the employer is released. Conversely, in Rabbah's view, recourse is available so that the employer remains liable. The first alternative sub-scenario involves an implied absolute renunciation on the basis of the assumption of a guarantor's liability by the paymaster. In this context, the disputation is as to whether, upon the default in payment of the paymaster, recourse against the employer is available to the worker, who did not specifically attach any condition to his agreement to be paid by the paymaster.

Rav Shesheth appears to endorse both the guarantee undertaking of the paymaster and its falling into the category under which the primary debtor (the employer) receives an absolute discharge; he further seems to be of the view that the worker's implied renunciation is fully effective. Conversely, it is not all that obvious from Tosafot whether Rabbah's view is premised on a rejection of the guarantee theory, on a disapproval of the treatment of the guarantee as falling into the category under which the principal debtor is discharged, or else on deeming an implied renunciation as inadequate to generate a discharge.

As further indicated,<sup>47</sup> **the second, alternative, sub-scenario laid down by Tosafot is that of an express renunciation by the worker of his recourse against the employer, on the condition of payment made by the paymaster.** Contrary to the renunciation under the first alternative sub-scenario, which is absolute but implied, **renunciation under the second, alternative, sub-scenario is conditional yet express.** Thereunder, the worker reserves the recourse right against the employer in the case of default or non-payment by the paymaster. Also, unlike in the case of the first sub-scenario, which involves the guarantee undertaking of the paymaster, nothing is stated in the context of the second sub-scenario on the existence or absence of an undertaking by the paymaster.

As pointed out, other than expressly adding the reservation of the right to go after the employer upon default by the paymaster, the second sub-scenario is very much like the second 'obvious' setting of Tosafot; that of an express renunciation, conditional upon payment by the paymaster. In that latter setting, Tosafot pointed out that it is obvious that on its own stated terms recourse is available to the worker against the employer upon the default in payment by the paymaster.<sup>48</sup> This observation appears to be fully applicable to the second, alternative, sub-scenario, so that in its context there is no disputation on this point; rather, in Tosafot's view, in the context of the second, alternative, sub-scenario,

and to pursue recovery from the debtor-employer only upon the default by the paymaster, would have allowed the guarantor-paymaster to derive satisfaction. Hence, dispensation of *kinyan* on the basis of derived satisfaction explains why in our scenario the paymaster's undertaking is not an ordinary guarantee, in which the guarantor is secondarily liable; yet it does not explain why in our scenario this is necessarily a guarantee of the type in which the debtor is absolutely discharged and the guarantor becomes the sole debtor. The point is not discussed by commentators and will not be further addressed here.

<sup>47</sup> Above, text that follows n 35.

<sup>48</sup> *Ibid.*

the disputation between Rav Shesheth and Rabbah is whether recourse from the employer is available to the worker even in the absence of default by the paymaster.

At its core, the disputation is then as to whether conditional release or discharge is effective. According to Rav Shesheth, conditional discharge is effective so that no recourse is available to the worker against the employer, as long as the paymaster has not defaulted. Conversely, Rabbah's view appears to be that recourse is available notwithstanding the conditional release. Stated otherwise, Rabbah's position is that conditional release is not effective, so that the employer remains liable notwithstanding the worker's agreement to be directed to the paymaster, in which case recourse against the employer is available to the worker throughout, both before and after the paymaster's default.

No rationale is immediately discernible from the discussion by Tosafot to explain the different conclusions of the sages with regard to the second sub-scenario. Both Rav Shesheth and Rabbah agree that an oral explicit renunciation is effective on its own terms; certainly, Rav Shesheth's view is premised on this position. What is unclear then is on what grounds Rabbah declines to apply this principle in the context of the second sub-scenario.

### 2.3 Other Commentators – Elaborating Tosafot's Discussion

Having accepted the premise of a scenario dealing with the extension of credit by the paymaster to the employer-debtor, commentators focus on the availability of recourse by the worker-creditor against the employer in the context of the two sub-scenarios of Tosafot. Overall, their discussion is on three levels. *First*, it endeavours to fill in blanks in Tosafot's analysis. *Second*, the discussion purports to determine which is actually the sub-scenario discussed in the Gemara, namely whether it is of an implied absolute discharge or express conditional discharge. *Third* and last, commentators aim to rule as to which of the two sages' positions regarding the availability of recourse is to prevail. As mentioned above, recourse is to be precluded according to Rav Shesheth, and available according to Rabbah.

In connection with the *first sub-scenario* – that of an implied absolute discharge based on reliance on the paymaster's undertaking – Nimukei Yoseph<sup>49</sup> explains the binding effect or irrevocability of the implied guarantee of liability of the storekeeper or moneychanger as premised on the nature of his calling. Stated otherwise, the storekeeper, as a trader, or the moneychanger, who deals with money, is understood to be unable to revoke his undertaking. Thus, the storekeeper or moneychanger is bound by his undertaking, even in the absence of a loan or deposit owed by either of them to the employer. In the view of

<sup>49</sup> Nimukei Yoseph, D'H 'Hozer' commenting on Talmud, *Bava Metzia* at 68A (of Rif's page numbering).

Nimukei Yoseph, both Rav Shesheth and Rabbah are to be taken as in agreement on that premise; that is, that of the binding effect, or irrevocability, of the payment obligation of the paymaster to the worker.

Nimukei Yoseph does not discuss the possibility of a disagreement between Rav Shesheth and Rabbah as to the nature of the guarantee undertaken by the paymaster; that is, whether the guarantee is an ordinary one under which the employer is not discharged,<sup>50</sup> or of the category under which the guarantor is fully discharged. The former classification would have supported Rabbah's view that recourse is available, while the latter classification would have supported Rav Shesheth's opinion that recourse is not available. Rather, according to Nimukei Yoseph, the disputation revolves around the effectiveness of an oral implied renunciation in reliance on the paymaster's irrevocable guarantee obligation. Thus, Rav Shesheth is of the view that a renunciation implied from the worker's explicit reliance on the paymaster is fully effective so as to discharge the employer. Conversely, Rabbah is of the opinion that to effectively release the employer, even in such circumstances, an express renunciation ought to have been made by the worker.

It is, however, unclear whether according to Nimukei Yoseph the two sages disagree on the adequacy of an implied renunciation in general, or on the facts of the case. To the latter end, Rav Shesheth may be of the view that once there is a guarantee of the category under which the borrower is not liable, no recourse against him is available, and hence no express renunciation of such recourse may be needed; renunciation may simply be implied from the nature of the guarantee relied upon. Conversely, Rabbah may be taken to draw a distinction between two situations in which a guarantor becomes the primary debtor. On one hand, there is the usual case of a borrower who received the lender's money through the guarantor, and who has never been liable, so that no recourse has ever been available against him. On the other hand, there is the case of the employer who was liable to the worker in the first place, and who allegedly becomes discharged due to the creditor's reliance on the guarantee, making the guarantor the primary debtor. According to Rabbah, then, while an express renunciation is not needed in the former case, it is certainly required in the latter.

Other commentators focus on the *second sub-scenario* – that of an explicit conditional discharge of the employer by the worker, attached to the worker's agreement to be paid by the paymaster. In this context, an express condition is attached to the worker's agreement to be paid by the paymaster; that condition suspends the employer's obligation until default of the paymaster. Right to recourse upon default is however explicitly reserved. Commentators' remarks mostly endeavour to rationalize Rabbah's position, effectively invalidating this

<sup>50</sup> Yet to allow recovery first from the guarantor-paymaster and only then from the employer-debtor, the guarantee ought to be of the type '*arev-kablan*'. See Tosaft in Talmud, *Bava Batra* at 173B, discussed above in n 43. Cf Rashi in *Bava Metzia* at 62A, D'H 'Detanan', speaking of a guarantor who is an intermediary between the lender and the borrower, namely a guarantor who is liable directly and unconditionally to the lender and is entitled to recover from the borrower.



condition, by stating that, notwithstanding such an express condition, recourse from the employer is available to the worker throughout. That is, recourse is available even in the absence of, or prior to, default by the paymaster. In other words, the employer had not been discharged, even temporarily, and remained liable to the worker, irrespective of the qualified or conditional renunciation expressed by the worker.

A common explanation of Rabbah's position, denying efficacy to the release of the employer by the worker until default by the paymaster, is premised on the revocability of the payment obligation of the paymaster. According to the Rosh, the conditional release given to the employer by the worker must be taken to be mistaken, and thus not binding, since the payment obligation of the paymaster is revocable.<sup>51</sup> The Mordechai strengthens the mistaken release theory by adding that the worker is aware of the employer's power to countermand payment, that is, to revoke the authority given to the paymaster to pay, and thus cannot be taken to release the employer, lest no one will remain liable to pay him his wages.<sup>52</sup> In connection with the second sub-scenario, Rav Shesheth, denying recourse, is taken to accept, at face value, the validity of the employer's release by the worker until default by the paymaster.

It is possible to view the analysis of the *first sub-scenario* (an implied absolute renunciation on the basis of a guarantee) as premised on the irrevocability of the paymaster's obligation, with Rav Shesheth and Rabbah disagreeing on the effect of an implied renunciation derived from the reliance on that obligation. Conversely, in the context of the *second sub-scenario* (an express discharge of the employer's obligation until default by the paymaster), Rabbah's position, invalidating the conditional discharge given by the worker to the employer, is premised on the revocability of the paymaster's obligation. At the same time, in connection with the second sub-scenario, Rav Shesheth's position, validating the express conditional discharge, is consistent with both premises, that of revocability and irrevocability of the paymaster's obligation, or in fact, where there is no obligation at all on the part of the paymaster. In other words, if release of the employer is effective even when the substituting promise of the paymaster is revocable, release ought also to work in the comparable case of absence of a commitment; furthermore, it is obvious that release ought to be effective in the easier case in which the substituting promise is irrevocable.

Not all aspects of the discrepancy between Tosafot's two sub-scenarios, as subsequently analysed by commentators, are entirely obvious. Indeed, per Tosafot, in the first sub-scenario, renunciation is absolute though implied; in the second sub-scenario it is conditional yet express. This indeed is an obvious factual discrepancy. However, per Tosafot, in the first sub-scenario, the paymaster's undertaking is in the form of an implied guarantee; at the same time, neither the existence of a paymaster's undertaking, nor its absence, is stated in the

<sup>51</sup> Rosh, D'H 'Ibaei lehu' commenting on Talmud, *Bava Metzia* at 112A.

<sup>52</sup> The Mordechai, D'H 'Himchahu' commenting on Talmud, *Bava Metzia* at 112A.



second sub-scenario.<sup>53</sup> For their part, commentators<sup>54</sup> strictly followed Tosafot as to the renunciation point; yet, in preferring Rabbah's position to that of Rav Shesheth as to the availability of recourse in the second sub-scenario, commentators discussed the irrevocability of the paymaster's undertaking; thereby, they filled in a blank in Tosafot's second sub-scenario, by adding an undertaking given by the paymaster.

In the context of the second sub-scenario, that of an express conditional discharge, commentators thus agree with Rabbah that in the absence of a paymaster's binding undertaking, recourse is available to the worker-creditor against the employer-debtor. Unfortunately, however, it is not obvious whether they are to be taken to reject the possibility of an implied irrevocable guarantee by the paymaster, on which Rav Shesheth and Rabbah may agree in the context of the first sub-scenario;<sup>55</sup> in such a case, there is a discrepancy in the legal analysis of the two sub-scenarios. Alternatively, having accepted in principle the possibility of an implied irrevocable guarantee given by the paymaster in the second sub-scenario, such commentators may be taken to assert that in the facts of the second sub-scenario, required language, or perhaps any other condition, for the guarantee have not been met. If the latter, discrepancy on the point is merely factual; an implied irrevocable guarantee is then said to exist in the first sub-scenario but not in the second one. In such a case, however, Tosafot's absence of discussion on the language or circumstances required for the implied guarantee is most unfortunate, as there is no indication whatsoever as to the circumstances under which an implied guarantee will arise under the first sub-scenario, as opposed to an irrevocable undertaking under the second sub-scenario.

The final ruling in Jewish law appears to treat the *Bava Metzia* narrative as relating to the *second sub-scenario* – that of an **express conditional discharge pending default by the paymaster**. As well, the final ruling in Jewish law appears to side with Rabbah's position as to the **lack of validity of the conditional discharge, which allows the worker to have his recourse against the employer throughout, namely, even prior to and irrespective of default by the paymaster**. The rationale given is that of the revocability of the paymaster's obligation, such revocability being premised on the absence of any deposit or loan owed by the paymaster to the employer.<sup>56</sup> This may be taken to reject as a matter of law the binding effect of the implied guarantee also per the first sub-scenario, and thereby to harmonize the treatment of the two sub-scenarios, with both taken to be premised, as a matter of law, on the revocability of the paymaster's obligation.

<sup>53</sup> Above, text that follows n 35.

<sup>54</sup> See eg Rosh, above n 51 and Nimukei Yoseph, above n 49.

<sup>55</sup> See text around nn 37–38 above.

<sup>56</sup> See Tur, *Choshen Mishpat*, Section 339 and Shulchan Aruch, *Choshen Mishpat*, Section 339.

## 2.4 Which Scenario? – Aspects of Tosafot's Analysis Revisited

The acceptance of Rabbah's premise (recourse is available irrespective and prior to default) and reasoning (mistaken renunciation) in the context of the *second sub-scenario* (an express discharge conditional on payment by the paymaster) may appear to reopen Tosafot's ruling on the two initial settings, in which the answer was supposed to be 'obvious'.<sup>57</sup> The *first setting* was where the worker, in agreeing to be paid by the paymaster, explicitly released the employer, even in the where case the paymaster would not pay. The *second setting* was that when the worker, in agreeing to be paid by the paymaster, explicitly made the release or discharge of the employer contingent or conditional on actual payment by the paymaster. In Tosafot's view, it was 'obvious' that recourse was not available to the worker in the first setting, that of an express absolute release of the employer by the worker; it was equally 'obvious' that recourse was available, upon non-payment or default by the paymaster, in the second setting, that of an express conditional release of the employer by the worker. In both such cases, the existence or absence of recourse was made dependent on the express renunciation included in the worker's agreement to be paid by the paymaster.

Yet, at first blush, if the paymaster's obligation is revocable so that the worker's attempted expressly stated conditional release fails as a mistaken release, per Rabbah's view in the context of the second sub-scenario, it is hard to see why the express absolute discharge of the employer, per the first setting dismissed by Tosafot as 'obvious', will work better. Stated otherwise, arguably, discharge ought to be taken to be mistaken, and hence ineffective, not only when it is conditional (Rabbah's view for the second sub-scenario), but also, and in fact more so, when it is absolute (Tosafot's first 'obvious' setting); that is, if the obligation of the paymaster is revocable, an absolute discharge will leave the worker with no remedy whatsoever upon the revocation by the paymaster, as the worker may then be unable to go back and recover from the employer. The absolute discharge must then be seen as mistaken and invalid. Hence, the acceptance of Rabbah's premise and reasoning in the context of the second sub-scenario may result in the reversal of the 'obvious' conclusion reached by Tosafot for the first initial setting presented by him.

True, as suggested by Nimukei Yoseph,<sup>58</sup> Rabbah may still be seen as agreeing to the validity of an absolute discharge based on the irrevocable guarantee of the employer, but not to an absolute discharge purportedly given in the absence of such a binding undertaking. It is nevertheless possible to come up with an alternative explanation for Tosafot's position under which it is only the renunciation in the second sub-scenario, but not renunciation in the first 'obvious' setting, which is mistaken and hence invalid. The key is Tosafot's view as to the meaning of a mistaken renunciation, which emerges from another part of the

<sup>57</sup> Above section 2.2, particularly text around n 33.

<sup>58</sup> Above n 49.

same discussion on the *Bava Metzia* text, dealing with a related matter. Thus, in Tosafot's view, to be effective, renunciation given as part of a compromise or settlement of a monetary dispute cannot be oral and requires an act of *kinyan* (meaning a proprietary act);<sup>59</sup> this is so since the party who would have won in court would not have settled had he known he would have won. Stated otherwise, in Tosafot's view, mistaken renunciation is not only renunciation based on mistaken belief in the existence of a state of facts that actually does not exist, but also renunciation based on risk taken as to contingent facts.

On these grounds, it is only an oral conditional renunciation, as in the second sub-scenario, but not an absolute one, as in the first 'obvious' setting, that can be viewed as mistaken. Furthermore, per this reasoning, a conditional renunciation is inherently, by its nature, mistaken, since the existence of 'conditions' that may or may not be met gives rise to uncertainty, on which an oral renunciation cannot be based free of error. Arguably then, commentators who explain Rabbah's position under the second sub-scenario as premised on the mistaken basis of the employer's release by the worker adhere to Tosafot's expanded understanding of 'mistake' as covering uncertainties due to contingencies.<sup>60</sup>

There may also be an apparent contradiction between Rabbah's position as to the second sub-scenario and Tosafot's view as to the second 'obvious' setting. Thus, Rabbah's position for the second sub-scenario invalidates the worker's explicit undertaking to discharge the employer until default in payment by the paymaster. Consequently, the worker's recourse against the employer is not to commence upon the default in payment by the paymaster, as it may under Tosafot's second initial 'obvious' setting. In that setting, the employer's discharge is explicitly made by the worker contingent or conditional on actual payment by the paymaster. Rather, in Rabbah's view with regard to the second sub-scenario, recourse from the employer is to be available to the worker throughout, irrespective of his agreement to be paid by the paymaster. Hence, the acceptance of Rabbah's premise and reasoning for the second sub-scenario results in either the reversal, or bypassing of the significance, of Tosafot's 'obvious' conclusion as to the second initial setting; if the employer is not discharged prior to the default by the paymaster, there is no employer's liability to be invoked upon the default by the paymaster. Stated otherwise, if the express discharge of the employer until default by the paymaster is ineffective so that the employer remains liable throughout, per Rabbah's position for the second sub-scenario, liability of the employer cannot be seen as triggered by the default by the paymaster, as may Tosafot's 'obvious' conclusion for the second initial setting be understood to state.

<sup>59</sup> See above, text at nn 29–32.

<sup>60</sup> For such commentators, see above, text and nn 51–52. Compare and contrast with *Bava Metzia* at 66B–67A, discussing the avoidance of an obligation incurred on the basis of either mistaken renunciation, or in the belief that a stated condition thereto will not be fulfilled, in which context 'mistake' is more conventionally understood to refer to the mistaken belief in the existence of a state of facts (or law) that actually does not exist.

In the final analysis, however, Tosafot's conclusions for both the second 'obvious' setting and the second sub-scenario are reconcilable; both involve the same stipulation by the worker, namely that of conditional renunciation upon payment. What is added in the second sub-scenario, namely, an express reservation of recourse upon non-payment, is in fact a double stipulation,<sup>61</sup> which ought to be taken as implied also in the second 'obvious' setting. For the second 'obvious' setting, Tosafot is to be taken to say only that it is clear that per the language expressing the renunciation, recourse is available upon non-payment; Tosafot is not to be taken as implying anything, then, on the availability of recourse prior to that, a point which he subsequently discussed in the context of the second sub-scenario, on which the views of Rabbah and Rav Shesheth vary.

## 2.5 Talmudic Text in *Shevuot* – Tosafot's Position Supported

Support for Tosafot's position as to the centrality of the renunciation issue and insight on whether the *Bava Metzia* narrative requires the presence of all three<sup>62</sup> may be derived by comparison to another Talmudic text, in *Shevuot*.<sup>63</sup> The situation dealt with there is that of a charge (debit) in the books or ledger of a storekeeper arising from a payment or sale made in alleged compliance by the storekeeper with an instruction given by a person; such an instruction was to provide wheat to the instruction-giver's son or small-value coins to his worker. The Mishna discusses a case in which the worker and the storekeeper disagree as to whether the storekeeper complied. It rules that whenever the worker denies receipt of payment claimed to be made by the storekeeper, the employer is to pay both, that is, the storekeeper and the worker.<sup>64</sup> This continued liability of the employer indicates the availability of recourse to the worker against him.

Two points ought to be highlighted. First, the text in *Shevuot* does not raise the issue of recourse by the worker against the employer; it appears to take its existence for granted. Second, the *Bava Metzia* narrative does not even refer to the *Shevuot* text; yet, it could have been expected that Rabbah would rely on the

<sup>61</sup> A double stipulation states both the positive and negative side of an obligation; it is a condition stating both what will happen upon its compliance and upon its breach. See Talmud, *Kiddushin* at 61A.

<sup>62</sup> A question left open in text around n 20 above. For the renunciation of recourse as central to Tosafot's position see section 2.2 above.

<sup>63</sup> Talmud, *Shevuot* at 45A, and Jerusalem Talmud, *Shevuot* at 36B, discussed immediately below.

<sup>64</sup> For this interpretation see Pnei Moshe commentary to the Jerusalem Talmud, *Shevuot* (Talmud at 36B) and to a similar end, in the Talmud, *Kiddushin* at 43B. There is a disputation in the Mishna in *Shevuot* (at 45A in the Bavli Talmud; at 36B in the Jerusalem Talmud), irrelevant for our purposes, as to whether, to be successful in their claims against the employer, both the worker and the storekeeper need to take an oath. As well, note that the Talmudic discussion in *Shevuot* equally covers the father and son scenario, and not only that of the employer and worker, to which attention is restricted in the present discussion. Yet, it will be noted that the initial entitlement of the son from the father, unlike that of the worker from the employer, is not all that obvious. Arguably, the father and son case is relevant only to the oath-taking aspect of the text, and is not to be taken as implying father's liability to his son. See Tosafot Yom Tov, D'H 'Ten livni' commenting on Mishna, *Shevuot*, Section 7, Rule 5.

*Shevuot* discussion as supporting the availability of recourse and that Rav Shesheth would endeavour to distinguish it so as to justify lack of recourse according to his own analysis. It seems then that it was obvious to all concerned that the two Talmudic texts do not deal with the same scenario; indeed, in the *Bava Metzia* text the direction given by the employer-debtor is addressed to the worker, namely to the creditor, to go and collect from the paymaster. Conversely, in *Shevuot*, the direction is given by the employer to the paymaster, to pay the worker. And while either way a double direction from the employer is required – one to the worker to go and get paid, and the other to the paymaster to pay – the emphasis in each scenario on one direction is not without implications.

Thus, the issue of renunciation, with which Tosafot's analysis to the *Bava Metzia* narrative is concerned, is a matter arising between the employer and the worker; it arises in a scenario involving them both, as when the employer directs the worker to go to the paymaster. At the same time, no renunciation comes up in that part of the scenario in which the worker is not involved; that of the direction given by the employer to the paymaster, as in *Shevuot*. By itself, the direction dealt with in *Shevuot* neither entitles nor binds the worker, who thus remains entitled to recover from the employer at any time. It is in fact the absence of any modification of the worker's rights on which the *Shevuot* text focuses. Conversely, in the *Bava Metzia* text, it is the worker's consent to abide by and follow the employer's direction which is determinative; hence, it is only then that the issue of the modification of his rights, in the form of renunciation or loss of recourse, arises.

Indeed, in the Jerusalem Talmud, the Gemara in *Shevuot* limits the case dealt with by the Mishna, that of the direction addressed to the storekeeper, to a situation where the instruction is not given in the presence of all three. It is only then, that is, when the worker is not even present at the time the instruction is given by the employer to the storekeeper, that the employer-debtor remains liable to the worker-creditor. Conversely, where all three are present at the time the instruction is given, that is, when the worker has been present, the Gemara in the Jerusalem Talmud categorically states that the employer has been discharged and recourse is available to the worker only against the storekeeper.<sup>65</sup>

Obviously then, in holding that the storekeeper is liable and cannot renege,<sup>66</sup> the Gemara in the Jerusalem Talmud envisages a case in which the storekeeper undertook to pay. The Ridvaz takes the position that in such a case it is 'as if' the storekeeper owed money to the employer who had paid him in advance; yet

<sup>65</sup> Talmud, *Shevuot* at 36B–37A. The Gemara text distinguishes between a situation in which the employer 'did not make the worker stand [before the storekeeper] with him', namely with the employer, in which case there is recourse, and the situation in which the employer 'made the worker stand [before the storekeeper] with him', namely the employer, in which case there is no recourse. Pnei Moshe and Ridvaz on the Gemara page are more explicit in characterizing the latter situation, in which recourse is lost, as involving the presence of all three.

<sup>66</sup> As Pnei Moshe explains the Gemara text in the Jerusalem Talmud, in such a case, the risk falls on the storekeeper, who cannot avoid liability by directing the workers to the employer who had been released, regardless of whether payment by the storekeeper is disputed or remains to be made.

in fact, no advance had actually been made, and even without a debt owed by the storekeeper to the employer, the employer is discharged and the storekeeper may not renege. Mareh Hapanim is of the same opinion; in his view, the case dealt with by the Jerusalem Talmud is one in which the storekeeper extends credit to the employer, which is the same as in the *Bava Metzia* text. In the view of Mareh Hapanim, the Gemara in the Jerusalem Talmud thus appears to follow Rav Shesheth, who in his controversy with Rabbah in *Bava Metzia* precludes recourse against the employer; yet, per Mareh Hapanim, ultimately, ‘the law is not according to him’, but rather, according to Rabbah, who permits recourse against the employer.

It thus emerges that in the footsteps of the *Bava Metzia* scenario, the *Shevuot* Gemara in the Jerusalem Talmud deals with a case in which credit is extended by the paymaster/storekeeper to the employer. Indeed, in fastening liability on the storekeeper and discharging the employer, the *Shevuot* Gemara in the Jerusalem Talmud may well be at variance with ‘the law’ which subsequently prevailed; what matters to us, however, is that in distinguishing itself from the *Shevuot* Mishna the *Shevuot* Gemara in the Jerusalem Talmud contrasts that Mishna with the *Bava Metzia* scenario by envisaging the latter to apply where all three are present together.

Among the early commentators, both Rif<sup>67</sup> and the Rosh<sup>68</sup> are quite explicit in relying on the *Shevuot* Gemara in the Jerusalem Talmud as the basis for their own respective treatment of two points. The first is Rav Shesheth’s position on the loss of recourse in the *Bava Metzia*’s narrative. The second point is the confinement of that position to a situation where all three are present.<sup>69</sup> In the Rosh’s view, this position is further limited specifically to **the first of Tosafot’s sub-scenarios; that of the implicit absolute renunciation by the worker based on the paymaster’s guarantee.** Tosafot’s commentary to the *Bava Metzia* text is more ambiguous;<sup>70</sup> in dealing with that first sub-scenario, he mentions the revocation power of the paymaster who does not owe anything to the employer and states it to exist ‘even in the presence of all three’. Later on he mentions the Jerusalem Talmud Gemara in *Shevuot* to refute the possibility that the *Bava Metzia* text, instead of dealing with recourse against the employer, is actually concerned with a **third sub-scenario, that of the reinstatement of the worker’s remedy for the violation of the prohibition against delaying payment.**<sup>71</sup>

Among the later commentators, Kessef Mishna analyses the disputation in the *Bava Metzia* text in the context of a presence-of-all-three scenario. He addresses the disputation as relating to whether, in order to be effective, the

<sup>67</sup> Rif on Talmud, *Bava Metzia* at 68B (of Rif’s page numbering). For a comprehensive discussion on the Rif’s position, drawing also on additional sources, see Y Francus, ‘The Rif’s Methodology in the Law Concerning Presence of All Three’, (5748/1988) 102 *Sinai* 196 [in Hebrew].

<sup>68</sup> Rosh, above n 51.

<sup>69</sup> For Rav Shesheth’s position and a preliminary discussion on whether the *Bava Metzia* narrative is confined to a case where all three are present together, see above section 2.1.

<sup>70</sup> Tosafot, D’H ‘Hozer’ commenting on Talmud, *Bava Metzia* at 112A.

<sup>71</sup> For the third sub-scenario, see above n 34.

worker's renunciation in the presence of all three must necessarily be express or whether it is sufficient for the renunciation to be implied.<sup>72</sup> This assumes that an express renunciation is effective. Accordingly, under this analysis, there is no controversy as to the *second sub-scenario* of Tosafot, that of an *express conditional discharge*. Rather, it follows from this analysis that the disputation in the *Bava Metzia* text is limited to the case of the *first Tosafot sub-scenario*, that of the *implicit renunciation on the basis of the paymaster's guarantee*.

Certainly, speaking of the direction given to the paymaster to pay the worker, the text of the Mishna in *Shevuot* ought to be taken as not purporting to affect the worker's own rights; he is to obtain payment of money and not a payment obligation from the paymaster, and is to remain entitled to obtain payment in money solely from the employer. Neither the accrual of a right against the paymaster nor the loss of a right against the employer is to take place, and hence there is no need for the presence of all three, or in fact for any mechanism, to create rights and duties.

At the same time, speaking of the direction given to the worker by the employer to be paid by the paymaster, the *Bava Metzia* text ought to be taken as positioning the worker as dealing with both the employer and the paymaster. It is on the basis of what the paymaster tells the worker that the worker is purporting to renounce the recourse against the employer. This is particularly obvious in the *first sub-scenario* (an implied absolute discharge based on reliance on the paymaster's undertaking), in which renunciation is on the basis of the paymaster's guarantee to the worker. Strictly speaking, in Tosafot's *second sub-scenario* (express conditional discharge), communication is a matter exclusively between the employer and the worker;<sup>73</sup> hence, there is no pressing need to see it as being confined to the presence-of-all-three scenario. Yet, as discussed, commentators also treat the second sub-scenario as involving an undertaking by the paymaster, albeit a revocable one.<sup>74</sup> Under this understanding, also, the second sub-scenario is better envisaged as involving the presence of all three together.

Hence it is more plausible to see all three standing together; the alternative is awkward: the worker, having received the direction from the employer, is to go to the paymaster, and having received from him an undertaking to pay, is now to return to the employer and make the renunciation.

Indeed, the view under which the loss of recourse in the *Bava Metzia* text is limited to circumstances where renunciation was made in the presence of all three may explain the paucity of discussion by commentators on the mechanism through which instructions are to direct the paymaster to pay the worker. Certainly, if all three are present, no issue arises as to formal writing requirements, flow of communication, authentication of instructions, or identification of the worker.

<sup>72</sup> Rambam, *Kinyan: Hilchot Mechira*, Section 6, Rule 8. On the renunciation in the various settings and sub-scenarios of the *Bava Metzia* text, see above section 2.2.

<sup>73</sup> See text above in section 2.2 that follows nn 35 and 53.

<sup>74</sup> See above section 2.3, particularly around n 56.



On the other hand, if all three are present, it is not all that obvious why the paymaster is not to pay the worker promptly, but is rather to undertake a deferred payment obligation, to be carried out at some point in the future.<sup>75</sup> Indeed, a delay may be understood to occur in the case of a paymaster-storekeeper, who is to extend credit by selling provisions to the worker over time; it is less understandable in the case of the paymaster-moneychanger who is to pay money to the worker. This is particularly so if the paymaster is bound by the prohibition against delaying payment, from which the employer has been released by virtue of the direction issued to the worker to obtain payment from the paymaster.<sup>76</sup>

True, the *Bava Metzia* text may be taken to be limited to unusual circumstances, such as where the moneychanger does not have enough cash at hand, at least of the desired small coins, or else, the entire meeting of all three occurs either late in the day, after what we may call today normal business hours, or not in the paymaster's place of business. This may however significantly reduce the relevance of the discussion to ordinary circumstances; unless of course moneychangers used to set up shop in the market but kept their money, at least in part, particularly other than small change, elsewhere, in which case customers with whom they transacted in the market often had to come later to that other location to obtain their money.

Another option, still adhering to the presence-of-all-three setting, is to treat the scenario as one in which the paymaster promptly pays the worker, not in cash, but rather by agreeing to hold with him an amount available to the worker, for full or partial withdrawals, on demand. Under this view, the paymaster's agreement to hold the amount for the worker will serve as 'payment' in compliance with the rule prohibiting delaying payment. In such a case, the disputation between Rabbah and Rav Shesheth is on the recourse available to the worker against the employer, as long as actual payment in money has not been carried out. This may be a way to see the *Bava Metzia* scenario as not limited to unusual circumstances.<sup>77</sup>

Perhaps a simpler explanation for the delay in anticipated payment by the paymaster, while still requiring all three to be present, is to treat the setting as

<sup>75</sup> Which was clearly the case in the scenario described in the Gemara in *Shevuot* in the Jerusalem Talmud at 36B, above n 65, in order to demonstrate a case in which the workers have no recourse against the employer.

<sup>76</sup> For the view that unless payment through the paymaster is agreed in advance, the requirement to comply with the rule prohibiting delaying payment passes from the employer to the paymaster, see Tosefta on Talmud, *Bava Metzia*, Section 10, Rule 1. On the compliance by the paymaster see Albeck, 'Assignment of Debt', above n 13 at 276–77. His reasoning is valid even without accepting his position of the paymaster's pre-existing indebtedness to the employer, discussed above in nn 21 and 23. As will be recalled, the prohibition against delaying payment to the worker was the main concern of the Mishna in the *Bava Metzia* narrative. See above, beginning of section 2.1.

<sup>77</sup> Nevertheless, under this view of the matter, attention ought to have been given to the position of the employer who, in reliance on the paymaster's agreement, may have already paid him in whole or in part money to be kept for the worker; lack of a discussion on the point strongly weakens this explanation for the delay.



one wherein the direction given to the worker by the employer to get paid by the paymaster is given prior to the end of the working day, that is, prior to the completion of the work, namely, before the entitlement to payment accrues. Actual payment is then to be made at the end of the day, upon the completion of work. Indeed, this may explain the delay in payment by the paymaster; yet, this would have made any undertaking of the paymaster conditional upon completion of the work by the worker, for which we have no indication in any of the texts or discussions.<sup>78</sup>

Another possibility in the context of a rule requiring all three to be present is to treat the scenario as referring to the case of a worker who completed his tasks in the course of the day, prior to its end, so that there is still time between then and the point of time, at the end of the day, in which the prohibition against delaying payment will be violated. In such a case, the paymaster's obligation may be given ahead of actual payment; in turn, actual payment is to take place, however, prior to the end of the day, before the prohibition against delaying payment is violated. While this fits the text, it is questionable whether this is such a typical case to draw so much attention.

Nevertheless, the existence of a paymaster's payment obligation prior to actual payment is not easily explained if the presence of all three is dispensed with. Even if the worker is to go on his own to the paymaster to demand payment, so that the presence of all three is not required, it is not clear why payment is not to be made on the spot, and why instead the paymaster's undertaking to pay in the future arises. It could however be argued, though admittedly quite tenuously, that such could be the case in one of a few situations. First, the case may fall into the second sub-scenario, as described by Tosafot and not as 'revised' by commentators, in which no undertaking is given by the paymaster. Second, in connection with the first sub-scenario, the situation may be that in which there is a standing obligation of the paymaster to pay the employer's workers, in which case it is *as if* the paymaster actually spoke to the worker advising him to rely on him, but in fact did not speak to him directly at all. Third, a similar standing obligation can be contemplated also by the commentators who read Tosafot's second sub-scenario as involving an undertaking, albeit a revocable one, of the paymaster.<sup>79</sup> In each such case the worker makes the renunciation, whose effectiveness and scope is the subject of the discussion, prior to coming to the paymaster.

**In the final analysis, the simplest explanation for the paymaster's deferred payment obligation may be that the worker is content with the obligation of the paymaster to pay him in the future and does not demand immediate payment,**

<sup>78</sup> The conditional order issue may further arise in connection with the view of the Tosefta, above n 76, under which the prohibition against delaying payment is violated by neither the employer nor the paymaster where payment through a paymaster is agreed upon in advance. In such a case, however, at the initial stage of the agreement, payment is instructed to be made conditional upon the completion of the work, unless both the worker and paymaster are to be re-directed at its completion. Texts do not discuss this 'two-stage' agreement followed by direction.

<sup>79</sup> See above sections 2.2 and 2.3.

to which he is entitled by virtue of the law prohibiting delay in the payment of wages. This explanation holds true whether or not the worker's renunciation ought to be made in the presence of both the employer and the paymaster. Indeed, the Gemara is quite explicit in stating that the prohibition against delaying payment of wages is violated when delay occurs notwithstanding the worker's demand;<sup>80</sup> that is, the clock is ticking as of the demand only, and delay in payment is not precluded if consented to by the worker, who foregoes the demand. The presence-of-all-three setting may then prevail only as it appears to better fit the transactional flow, and not because it gives a superior explanation for the paymaster's deferred payment obligation.

At the same time, for this explanation to be consistent with the role of the storekeeper or moneychanger as a paymaster and not surety, in line with the picture depicted by Rashi and adhered to throughout the entire analysis above,<sup>81</sup> an actual payment, albeit delayed, in either kind (by the storekeeper) or money (by the moneychanger) is to be envisioned. Reasons for and the extent of this delay, as well as the time for the employer's repayment to the paymaster, and any possible cost incurred by him in connection with the operation of the mechanism,<sup>82</sup> are neither specified nor amenable to deduction from available materials.

It seems that the Talmudic text primarily focused on the legal implications of the renunciation in the various situations; no adequate attention was given to the operation of the payment mechanism in connection with which the renunciation is given. Unfortunately, commentators have not addressed the time lag between the payment obligation and payment itself, which could have shed more light on and provided greater understanding of the mechanism. Certainly, however, both the delay in actual payment and, as already indicated in section 2.1 above, the probable existence of a presence-of-all-three requirement, reinforce the view of the scenario as dealing with the credit extension by a paymaster who does not owe money to the employer.

### 3. FINAL MODERN LAWYER'S OBSERVATIONS

Under modern law, a conditional discharge is implicitly given by the payee-creditor (the worker) to the drawer-debtor (the employer), in effect, of the type rejected by Rabbah in the context of the second sub-scenario. Thus, under modern law, upon the taking of the cheque, in temporarily renouncing, or in effect suspending his right of recourse against the drawer-creditor, the payee-creditor does not rely at all on any undertaking or representation emanating from the

<sup>80</sup> Talmud, *Bava Metzia* at 112A.

<sup>81</sup> See section 2.1, text in paragraph preceding the one containing n 13 above.

<sup>82</sup> Certainly, any such cost may not violate the prohibition to take interest mentioned in n 3 above.

drawee bank-paymaster;<sup>83</sup> rather, he exclusively counts on the contingent liability of the drawer-debtor. Upon the dishonour of the cheque by the drawee-paymaster, the drawer-debtor becomes liable on the cheque<sup>84</sup> and, alternatively, on the basic transaction.<sup>85</sup>

With respect to the *second sub-scenario*, that of an **express conditional discharge**, modern law thus appears to be quite consistent with Rav Shesheth's position precluding recourse until paymaster's default. However, in providing for a conditional discharge, modern law addresses a situation not read into the *Bava Metzia* narrative, namely, that of an **implied conditional discharge**. In that case, in line with Tosafot but not other commentators with respect to the second sub-scenario, modern law does not envisage paymaster's undertaking. At the same time, in upholding *implied* conditional discharge, modern law does not appear to depart from Rav Shesheth's position on the second sub-scenario, upholding *express* conditional discharge.

With respect to the *first sub-scenario*, that of an **implied absolute discharge**, the irrevocable undertaking given by the paymaster is not treated in modern law as a guarantee. It is either in the form of a bank's engagement on a certified, or its own, cheque, or in the form of a letter of credit. The better view under modern law is to see the former situation, that of the certification or the bank cheque, as typically giving rise to an absolute renunciation by the payee-creditor (worker) of his recourse against his debtor (the employer), the drawer of the certified cheque, or the remitter of the bank cheque.<sup>86</sup> In effect, while differing in its analysis as to the nature of the paymaster's obligation, the ultimate result follows the position of Rav Shesheth (precluding recourse altogether) under the first sub-scenario.<sup>87</sup>

Modern law and practice depart from Rav Shesheth's position in several respects. *First*, it is obvious that the presence of all three is not required; the debtor-employer directs the creditor-worker to be paid by the paymaster by either issuing his own cheque to the payee-worker, or by delivering to him a bank cheque issued by the paymaster. In turn, the presentation of this instrument by the creditor-worker to the paymaster constitutes the debtor-employer's direction to the paymaster to pay. *Second*, the scope of the renunciation is implied by law, rather than in fact. In any given case, the presumption of either conditional or absolute discharge can be rebutted; yet, the relevant presumption

<sup>83</sup> See eg in Canada, under the *Bills of Exchange Act*, R.S.C. 1985, c. B-4, s 126 (drawee is not liable on a bill unless he accepted it), as well as s 130 (no liability on a bill without a signature). A 'cheque' is a species of bill. See s 165.

<sup>84</sup> *Ibid* s 129(a). For dishonour by non-payment see s 94. Alternatively, he also becomes liable on the debt or basic transaction for which the cheque was given.

<sup>85</sup> This is so since payment by cheque is presumed to be conditional. See *Re Charge Card Services Ltd* [1988] 3 All E.R. 702 at 707 (C.A.).

<sup>86</sup> This is reflected eg in the US in U.C.C. §3-414(c).

<sup>87</sup> Conversely, the issue of the letter of credit is typically treated as conditional payment, releasing the debtor only on the condition of payment by the paymaster, the issuer of the letter of credit. See *WJ Alan & Co Ltd v El Nasr Export and Import Co* [1972] 2 All E.R. 127 at 136, [1972] 2 Q.B. 189 at 209.

arises without pursuing actual language and conduct of the parties. *Third*, payment by cheque is taken to occur at the time it was accepted by the payee/creditor even in conditional payment, and not at the time it is actually honoured;<sup>88</sup> the lag preceding actual payment does not pose any problem. *Fourth*, while credit extension by the paymaster to the creditor is quite conceivable, the typical situation, at least in which a cheque is issued, is where the debtor's funds are held with the paymaster.<sup>89</sup> *Fifth*, to be a cheque, a payment order must meet a few formal requirements. Particularly it must be written and unconditional.<sup>90</sup> In general, the modern lawyer cannot easily live with an oral payment order as well as with the proposition that the paymaster's payment obligation may depend on the performance of the underlying contract by the payee-creditor, which is one of the possible scenarios to explain the time lag between the payment obligation and actual payment.

In conclusion, the mechanism discussed in the *Bava Metziah* Talmudic text involves neither writing nor funds on deposit. It involves a demand possibly made by the creditor on the paymaster only in the presence of the debtor, and leaves recourse to be continuously available to the debtor against the creditor. Notwithstanding the temptation to conclude to the contrary,<sup>91</sup> neither cheques nor a cheque system are proven to have been envisioned by the Talmud in connection with this mechanism. While the *Bava Metziah* Talmudic text and related commentaries may have foreseen interesting forthcoming issues, it is premature to treat these materials as discussing cheques or as containing a nascent cheque law.

#### APPENDIX: GLOSSARY OF POST-TALMUDIC JEWISH LAW SOURCES

Note: this glossary is compiled on the basis of publicly available sources and is designed to assist the reader through chapters four and seven as well as section 2 of chapter two. For the Talmud, see note one above.

**Baal Ha-Itur (Rabbi Yitzchak ben Rabbi Abba Mari):** (approx 1122–1193) Baal Haitur is called after his renowned book, *Haitur*. He was born in Provence but spent most of his life in Marseilles, France. *Haitur*, his main publication, is comprised of three parts: the first one discusses monetary laws, the second one is about prohibitions and permissibles (*issur veheter*) and the last one discusses Jewish holidays.

<sup>88</sup> As pointed out by Megaw LJ in *The Brimnes Tenax Steamship Co v The Brimnes (Owners)* [1974] 3 All E.R. 88 at 111–12 (C.A.).

<sup>89</sup> The drawee bank's contractual duty to pay is subject to the availability of either funds in the drawer-customer's account, or of an overdraft facility to him or her. See *Barclays Bank v W J Simms Son & Cooke, Southern* [1980] Q.B. 677 at 681 (Goff J.).

<sup>90</sup> This is true for the cheque (see eg in Canada BEA, above n 83, s 165(1) in conjunction with s 16(1)) and transfer order (see eg in the US U.C.C. §4A-103(a)(1)(i)). Cf the letter of credit, with regard to which documentary (and no other) conditions are to be specified. ICC UCP 600 for Documentary Credits (2007 Revision) arts 2 (definitions of 'credit' and 'presentation') and 4–5.

<sup>91</sup> As set out in n 2 above.

**Bach (Rabbi Yoel ben Shmuel Sirkes):** (1561–1640) Bach authored the ‘Bait Hadash’, a major commentary on the Tur, where he establishes the source of the laws in the Talmud and traces their developments through the interpretations of different generations.

**Maharam (Rabbi Meir Lublin):** (1558–1616) Maharam is well known for his commentary on the Talmud, *Meir Einai Chachamim*. *Meir Einai Chachamim* is his best known work, a ‘casuistic commentary’ on the Talmud, Rashi, and Tosafot together. It is printed in all principal editions of the Talmud under the heading ‘Maharam’.

**Maharsha (Rabbi Shmuel Eliezer Edels):** (1555–1631) Maharsha wrote one of the most incisive and keenly analytical commentaries on the Talmud, Rashi and Tosafot. As a model of logic and terseness it was quickly accepted and was printed in almost all editions of the Talmud.

**Maharshal (Rabbi Solomon Luria):** (1510–1574) Maharshal is known for his work of Halacha, *Yam Shel Shlomo*, and his Talmudic commentary, *Chochmat Shlomo*. *Chochmat Shlomo* is a gloss, and comments, on the text of the Talmud. An abridged version of *Chochmat Shlomo* appears in nearly all editions of the Talmud today, at the end of each tractate. The original, separately printed version, is far more extensive.

**Maor Ha-Gadol (Rabbi Zerachyah ben Yitzchak Halevi of Lunel):** (1125–1186) Rabbi Zerachyah’s principal publication is the *Sefer Hamaor* (which he completed by the age of 19), in which some of the rulings of the Rif are disputed and which elicited opposition from, among others, R’Raavad and Ramban in his *Milchamot Hashem*.

**Meiri (Rabbi Menachem ben Solomon Meiri):** (1249–1316) Meiri summarized the subject matter of the Talmud, in his book *Beit Habechira*, giving both the meaning and the halacha derived from it. He utilized all the rabbinic literature available to him, so that his work may be considered a digest which gives a synoptic and comprehensive presentation of the whole expository and halachic activity up to his own time.

**Mordechai (Rabbi Mordechai ben Hillel Hakohen Ashkenazi):** (1240–1298) Mordechai published an halachic digest of the Talmud and early authorities following the format of the Rif. His commentary is published in almost all editions of the Talmud.

**Nimukei Yoseph (Rabbi Yoseph Chaviva):** (approx 1300–1400) Nimukei Yoseph wrote a commentary on the Rif which is included in the traditional edition of the Talmud for which no Ran exists.

**Pnei Moshe (Rabbi Moshe Margalioth ben Shimon):** (approx 1710–1781) *Pnei Moshe* is the most respected commentary on the Jerusalem Talmud, reflecting vast knowledge of both Talmuds. He authored two books, the *Pnei*

*Moshe* which is an explanation of the text of the Jerusalem Talmud (similar to Rashi) and the *Marei Hapanim* which is more analytical (similar to Tosafot).

**Raavad (Rabbi Avraham ben David):** (approx 1125–1198): Raavad is a highly regarded Talmudic scholar who lived in Posquieres, Provence. He wrote critical notations to Rambam's *Mishneh Torah* as well as to the Rif and to the Maor Ha-Gadol's *Sefer Hamaor*.

**Rambam (Rabbi Moshe ben Maimon, Maimonides):** (1135–1204) Rambam was the first person to write a systematic code of all Jewish law, the *Mishneh Torah*; he produced one of the great philosophic statements of Judaism, *The Guide to the Perplexed*; published a commentary on the entire Mishna; served as physician to the sultan of Egypt; wrote numerous books on medicine; and also served as leader of Cairo's Jewish community.

**Ramban (Rabbi Moshe ben Nachman, Nachmanides):** (1194–1270) Ramban, of Gerona Spain, was author of commentaries on the Torah, Talmud, and Maimonides' *Sefer HaMitzvot*. At an early age he wrote a defence (*Milchamoth Hashem*) of the Talmudic codification of the Rif, against the attacks of *Sefer Hamaor* (written by Maor Ha-Gadol). Late in his life, he was forced to become the representative of the Jews during the disputation of Barcelona, after which he left for the Land of Israel where he died.

**Ran (Rabbi Nissim ben Reuven):** (1320–1380) Ran was considered the greatest Halachic authority of his generation, and queries were sent to him from throughout the Diaspora. His works include commentaries on the Talmud and on Alfasi's code, Responsa, a recently published commentary on the Bible, and a collection of sermons.

**Rashba (Rabbi Shlomo ben Aderet):** (1235–1310) Rashba established, with thousands of Responsa, his reputation as one of the most, if not the most prolific of the 'Poskim', Respondents to questions of Jewish Law. And, by his commentary on all of the Talmud, he also established a reputation as one of the greatest 'Rishonim', Torah scholars of the Middle Ages.

**Rashi (Rabbi Shlomo ben Itzhaki):** (1040–1105) Rashi was the outstanding Biblical commentator of the Middle Ages. His concern was for every word in the text which needed elaboration or explanation. His simple, brief explanations for practically every phrase of the Gemara made the Talmud understandable to the non-scholar. Rashi's commentary appears in every edition of the Talmud. To this day, it is unthinkable to study Talmud without studying Rashi's commentary at the same time.

**Rif (Rabbi Isaac Alfasi):** (1013–1103) Alfasi is best known for his brilliant legal code, *Sefer ha-Halachot*. In it, he extracts all the pertinent legal decisions from three orders; Moed, Nashim, and Nezikin in addition to the entire tractates of Brachot and Hulin.

**Ritva (Rabbi Yom Tov ibn Asevilli):** (approx 1250–1330) Ritva's commentary on the Talmud is known for its clarity of thought and expression, and it is in very wide use throughout the Torah-learning world.

**Rosh (Asher ben Yechiel):** (1250–1328) Rosh was an eminent rabbi and Talmudist, best known for his abstract of Talmudic law. This work specifies the final, practical Jewish law, leaving out the intermediate discussion and concisely stating the final decision.

**Shulchan Aruch (Rabbi Josef Karo):** (1488–1575) Karo's magnum opus is his *Beit Yoseph* (*House of Joseph*), an encyclopedic commentary on Rabbi Jacob ben Asher's Tur, a halachic code. *Beit Yoseph* presents an extensive survey of relevant halachic literature, from the Talmud down to works of Karo's contemporaries. Karo's halachic decisions were codified in his *Shulchan Aruch* (which was actually a digest of *Beit Yoseph*). This work quickly became accepted throughout the Jewish world as halachically authoritative.

**Tosafot:** (eleventh, twelfth and thirteenth centuries) Tosafot were medieval rabbis who collected commentaries on the Talmud, and appear in virtually every edition since it was first printed. As such, they parallel Rashi in their importance. Tosafot are so named for their commentary, *Tosafot*, which translates as 'additions' or 'supplements'. This probably means that their authors and editors saw their work as supplements to Rashi's basic commentary.

**Tosafot Yom Tov (Rabbi Yom Tov Lipman Halevi Heller):** (1579–1654) Rabbi Yom Tov's major publication is a commentary on the Mishnah, which clarifies the Mishnah's text and makes it accessible to the non-scholar.

**Tur (Rabbi Jacob ben Asher):** (1270–1343) Tur's principal publication is the *Arba'ah Turim* (*Four Orders of the Code of Law*). The Tur followed the Rambam in arranging his work in a topical order. However, unlike the Rambam's *Mishneh Torah*, the *Arba'ah Turim* covers only those areas of Jewish religious law that were in force in the author's time. Rabbi Jacob did not deal with criminal law, let alone with the sacrifices or the Zera'im (agricultural precepts that could be observed only in the Holy Land).

**Yachin U'Voaz (Rabbi Yisrael Lipschutz):** (lived in the nineteenth century) Rabbi Lipschutz was the Chief Rabbi of Danzig. His commentary on the Mishnah is subdivided into two parts: the first one, *Yachin*, is more general and the second one, *Boaz*, is more analytical.

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# The Payment Order under Roman Law

|                                                                              |     |
|------------------------------------------------------------------------------|-----|
| 1. The Order to Pay and Compliance: An Overview                              | 191 |
| 2. The Debt Owed by <b>Paymaster</b> to <b>Debtor</b>                        | 194 |
| 3. The Legal Nature of the Delegation Order                                  | 201 |
| 4. Executing the Delegation: Introduction                                    | 208 |
| 5. Imperfect Execution: <i>Receptum</i> and <i>Constitutum</i>               | 210 |
| 6. Perfect Execution of the Delegation: Novation by Stipulation              | 214 |
| 6.1 Enforceability by <b>Creditor</b> of <b>Paymaster's</b> Undertaking      | 214 |
| 6.2 Scope and Impact of <b>Paymaster's</b> Undertaking                       | 217 |
| 7. Perfect Execution of the Delegation: Novation Other than by Stipulation   | 223 |
| 7.1 <i>Litis Contestatio</i>                                                 | 223 |
| 7.2 Acknowledgment of an Entry Posted to ' <i>Codex Accepti et Expensi</i> ' | 225 |
| 8. All Cards Shuffled: Delegation under the Reform Projects of Justinian     | 229 |
| 9. Cession: An Alternative to Delegation                                     | 233 |
| 10. Roman Law and Practice: Multipartite Applications of the Mechanisms      | 241 |
| 10.1 Introduction                                                            | 241 |
| 10.2 Circulation of Credit                                                   | 242 |
| 10.3 Payment to a Distant Party                                              | 244 |
| 11. Final Observations: The Uncertain Heritage of Roman Law                  | 246 |

## 1. THE ORDER TO PAY AND COMPLIANCE: AN OVERVIEW

While Latin has vocabulary describing various aspects of payment operations, the language used has been general. Hence, no comprehensive technical terminology, dedicated to payment mechanisms, has developed to define specific concepts with any legal precision.<sup>1</sup> Rather, in Roman law, the order to pay has been analysed as

<sup>1</sup> See J Andreau, *La Vie Financière dans le Monde Romain: Les Métiers de Manieurs d'Argent* (Rome: École Française de Rome Palais Farnèse, 1987) at 567–68 (hereafter: Andreau, *La Vie*). Particularly he mentions '*jubere et scribere*' as signifying 'giving an order of payment' and '*jussum*', '*jusio*' as well as '*scriptio*' designating the order of payment itself.

*delegatio*, or in English, delegation. In its narrow sense, the term has been defined as an order given by one person ('delegant') to another ('person to be delegated') to pay, or assume an obligation towards, a third person ('delegatee'). In its broader sense, it has also come to include the execution of the order.<sup>2</sup> As an order to pay money owed by one person to another, it is an order by the delegant, a payer/debtor ('Debtor'), issued to the person delegated, an intermediary/paymaster ('Paymaster'), to pay the delegatee, a payee/creditor ('Creditor'), a debt owed by Debtor to Creditor.<sup>3</sup> The execution of the order to pay envisages ultimate payment by Paymaster as a principal, with his own money, rather than as a messenger with money supplied to him by Debtor. Paymaster nevertheless discharges Debtor's debt, so that Paymaster's payment to Creditor is treated as one made to Creditor by Debtor himself.

There are no formal requirements for Debtor's order of which the delegation consists; the order may thus be oral or written; the order may 'even [be] a nod where the delegant is unable to speak.'<sup>4</sup> Where the order is to pay money owed by Debtor to Creditor, Paymaster's compliance with the order discharges that debt. Regardless, Paymaster may be a debtor of Debtor, in which case, in complying with the order, Paymaster obtains a discharge from Debtor. Thus, where Debtor owes Creditor and Paymaster owes Debtor, the effect of carrying out the order is to discharge both debts. Yet, Paymaster may comply with the order and pay Creditor even where Paymaster is not a debtor of Debtor; in such a case Paymaster is to become a creditor of Debtor, unless Paymaster has intended to make a gift to Debtor. Similarly, the delegant may order payment to be made to the delegatee not in discharge of a debt owed to the delegatee, but rather by way of gift or loan to him; if by way of loan, upon compliance by Paymaster, the delegant is to become creditor of the delegatee.

Among these possible scenarios, the ensuing analysis in this chapter focuses on the 'double-debt' case, in which delegant-Debtor owes to delegate-Creditor and Paymaster owes a separate debt to delegant-Debtor. Attention will first be given to the nature of the debt owed by Paymaster to Debtor, following which

<sup>2</sup> For the definition of *delegatio* see eg A Berger, *Encyclopedic Dictionary of Roman Law* (Philadelphia: American Philosophical Society, 1953) at 429. For an analysis of delegation, see eg HJ Roby, *Roman Private Law in the Times of Cicero and the Antonines* (Cambridge: Cambridge University Press, 1902) (also reprinted by Scientia Verlag Alen, 1975) vol 2 at 42–45. See also WA Hunter, *A Systematic and Historical Exposition of Roman Law in the Order of a Code*, 3rd edn (London: Sweet & Maxwell, 1897) at 631–32; R Dannenbring, trans, *Roman Private Law*, 3rd edn (Pretoria: University of South Africa, 1980, trans of M Kaser, *Römische Privatrecht*, 10th rev edn) at 269–70; and P Gide, *Études sur la Novation et le Transport des Créances en Droit Romain* (Paris: L LaRose, 1879) at 379–480. For a comprehensive discussion see S Maxwell, *De la Délégation en Droit Romain* (Bordeaux: Imprimerie Ve Cadoret, 1895) and P Rutsaert, *Étude sur la Délégation en Droit Privé Romain* (Bruxelles: Émile Bruylant; Paris: Recueil Sirey, 1929). See also R Lanata, *Thèse pour le Doctorat; Droit Romain: De la Délégation; Droit Français: De la Compétence des Tribunaux Français à l'Égard des Étrangers* (Paris: Imprimerie de Charles Noblet, 1882).

<sup>3</sup> Indeed, it is the benefit to the order giver from the execution of the order which turns an order into a delegation order. See eg A Badareu 'Tomsa', *De la Délégation Imparfait*, (Paris: M Giard & Brière, 1914) at 6.

<sup>4</sup> Roby, above n 2 at 44.

the legal nature of the delegation order, the effect of compliance with it, and the use of cession as an alternative to delegation, will be analysed. Discussion focuses on the Roman law of obligations arising from contracts, as developed up to the classical period, and ultimately codified, though with important modifications to be noted, in the projects of Justinian.<sup>5</sup>

While on their own, the pertinent Roman law doctrines and concepts have been extensively researched, the present analysis purports to build on such discussions. It is innovative in that it focuses on the application of Roman law doctrines to the payment order setting. Underlying relationships are summarized immediately below.

Contract in Roman law requires an agreement; yet the validity and scope of an agreement depends first on the category under which the contract is analysed,<sup>6</sup> and second, on the features of the specific type of contract, as for example by reference to the transaction to which it relates.<sup>7</sup> Contracts may fall into various categories, under two classifications. Under the first classification system, Roman law distinguishes among Real, Verbal, Literal, and Consensual contracts. In a real contract, obligations arise from the delivery of a thing (*res*). In a verbal contract, it is the form of the uttered words which give rise to an obligation. A literal contract creates obligations only on the basis of a special kind of writing. Finally, in a consensual contract, obligations arise on the basis of the mere agreement.

Regardless, under a second classification of Roman law, each contract is either (i) unilateral or bilateral, (ii) *stricti juris* or *bonae fidei*, or (iii) formal or informal. A unilateral contract is one in which the duty to perform is only on one party. Conversely, in a bilateral (or ‘synallagmatic’) contract there are reciprocal obligations. Such a contract may be either perfectly or imperfectly bilateral. In a perfectly bilateral contract, each side is under a duty from the moment the contract has been concluded. In an imperfectly bilateral contract, one party’s obligation is only contingent upon the occurrence of some circumstance. A *stricti juris* contract binds the promisor to the very thing he has promised, neither less nor more. Conversely, good faith is a factor in the enforcement of a *bona fide*

<sup>5</sup> The classical period of Roman jurisprudence is taken to extend from the beginning of the Empire, as of around 27 BCE, to the middle of the third century CE. However, the codification project of Justinian in the sixth century CE produced the major sources of Roman law, consisting of the Digest and Institutes, purported to consolidate all earlier sources to their exclusion. See in general, B Nicholas, *An Introduction to Roman Law* (Oxford: Clarendon Press, 1962) at 14–45, particularly at 34–45.

<sup>6</sup> In general, on obligations arising from contract under Roman law, see RW Lee, *The Elements of Roman Law with a Translation of the Institutes of Justinian*, 4th edn (London: Sweet & Maxwell, 1956) at 285–89.

<sup>7</sup> The various types of all such ‘nominate’ contracts are discussed by Lee, *ibid* at 290–340. A contract whose nature is difficult to determine, but which is undoubtedly binding, as eg, where it falls on the border-line between two types, is an ‘innominate’ contract; *ibid* at 340–42. In contrast, ‘An agreement which did not conform to any type of contract, nominate or innominate, was termed a “pact” or a “bare pact.” It did not ground an action, but might be pleaded as defence. . . . Progressively, however, certain pacts were made actionable, and so became contracts . . . in effect though not by name.’ Lee, *ibid* at 342.

contract. All unilateral contracts are *stricti juris* while all bilateral contracts are *bonae fidei*. Unlike in *stricti juris* contracts, at the discretion of the judge, a broader range of defences, not raised in the pleadings, may be introduced in *bonae fidei* contracts.<sup>8</sup> Finally, contracts are formal or informal. A contract is formal when its validity depends on its form; it is the form which makes the contract. At the same time, an informal contract derives its effectiveness exclusively from the intention of the parties. Being self-contained, namely, confined to the contours of the formula and not to any outside event, a formal contract is by definition *stricti juris* and hence unilateral; it may be referred to as abstract.<sup>9</sup> In contrast, an informal contract is based on some 'cause' other than the adherence to a formula, such as the delivery of an object or the actual agreement of the parties; hence, informal contracts are also called 'causal'.<sup>10</sup>

Falling under one category according to one classification, a contract may be disqualified from falling under one or more categories of the other classification. For example, formality is a matter of specific requirements as to either oral or written contractual language; by definition, a formal contract (under the second classification) may thus be neither consensual nor real. Rather, under the first classification, a formal contract may be either verbal or literal. By the same token, deriving its effectiveness exclusively from the intention of the parties, an informal contract (under the second classification) must be either real or consensual; under the first classification, it can be neither verbal nor literal. Also, as a rule, verbal and literal contracts are unilateral, *stricti juris*, and formal; at the same time, as a rule, consensual contracts are bilateral, *bonae fidei*, and informal. Similarly, most real contracts are bilateral, *bonae fidei*, and informal. However, at least the latter is not always the case; as discussed immediately below, the *mutuum*, covering the loan of money, is a real contract, which is indeed an informal and yet a unilateral *stricti juris* contract.

## 2. THE DEBT OWED BY PAYMASTER TO DEBTOR

In the pre-classical era, a monetary debt, including the one owed by **Paymaster** to **Debtor**, could be in a form of entry in a cash book of a Roman citizen. The cash-book was called *codex accepti et expensi* (or *depensi*); the making of the entry was called *expensilatio*. The entry itself was called *nomina transcriptia*;<sup>11</sup>

<sup>8</sup> An action on a bilateral contract sought an instruction to the judge to decide according to good faith; 'this empowered him to take into consideration equitable defences though not raised in the pleadings, and allowed him greater latitude of interpretation and of decision, so as to do substantial justice between the parties'. Lee, *ibid* at 286.

<sup>9</sup> It does not follow, however, that every informal contract is bilateral *bonae fidei*; as discussed at the end of the next paragraph, while this is usually the case, this is not so for the *mutuum*, which is a unilateral *stricti juris* yet informal contract.

<sup>10</sup> Lee, above n 6 at 287, who goes on to discuss how 'In the course of time abstract contracts tend to become causal.' For 'causa' or cause as reason or grounds, see in general Berger, above n 2 at 382.

<sup>11</sup> For these terms see Berger, *ibid* at 391, 464 and 596 respectively.

it gave rise to a formal literal contract, which by definition was *stricti juris* and unilateral. Hence it was abstract, and binding on the basis of the writing, irrespective of the actual transaction from which it arose and superseded. However, it ceased to exist as a form of obligation when the book-keeping system that underlay it fell into disuse.<sup>12</sup>

Liability on a monetary debt has come to depend on the type of contract that gave rise to it. Typically the debt owed by *Paymaster* to *Debtor* is either for money lent or for money deposited. Under Roman law, money lent and money deposited give rise to two distinct legal relationships, each derived from a specific type of contract. The *mutuum* is a loan for consumption of money or any other *res fungibiles*, namely, interchangeable things that are weighed, numbered, or measured. Delivery vests title and right to use on the recipient (the 'borrower') who becomes liable to return to the transferor (the 'lender') an equal amount of same quality objects at the agreed-upon time or upon demand. It is a unilateral, *stricti juris* and informal contract, fastening on the borrower an absolute duty.<sup>13</sup>

Money deposited usually gives rise to the irregular deposit (or the *depositum irregulare*). This is a deposit of an object, subject to a condition of restitution in genre, namely in equivalent amount, and not in specie. It entails the transfer of ownership in the object of the transaction to the depositary, and not merely the transfer of physical control or right of detention.<sup>14</sup> In terms of its classification, it arises from an informal real contract, giving rise to the depositary's obligation upon the delivery of the object.<sup>15</sup> Yet, the precise nature of this obligation, its underlying contract, and the other legal features of the transaction, require further analysis.

In fact, the irregular deposit combines elements derived from three types of real contracts.<sup>16</sup> All such real contracts are informal. They are the loan for the consumption (or *mutuum*), loan for use (or *commodatum*), and deposit (or *depositum*).<sup>17</sup>

<sup>12</sup> For more on the nature and history of this obligation, including on the distinction between the books on which it is entered and bank account books (*rationes*), see section 7.2 below.

<sup>13</sup> Liability to pay interest on money lent requires, however, an incidental contract, in the form of a stipulation (*stipulatio usuranum*). On the stipulation as a formal, verbal, unilateral and *stricti juris* contract, consisting essentially of a formal question and answer, see Lee, above n 6 at 298–304, and further discussion in section 6 below.

<sup>14</sup> In Roman law, the depositary's 'detention' is consistent with the depositor's continuous 'possession', as long as it purports to be on the depositor's behalf and not in challenge to the depositor's right. See in general, Lee, *ibid* at 179.

<sup>15</sup> In general, for the irregular deposit, see Lee, *ibid* at 295 and R Zimmermann, *The Law of Obligations – Roman Foundations of the Civilian Tradition* (Cape Town: Juta, 1990) at 215–19.

<sup>16</sup> In South Africa, this is the conclusion of DV Cowen, E Emmett and L Gering, *Cowen on the Law of Negotiable Instruments in South Africa*, 4th edn (Cape Town: Juta, 1966) at 368, where earlier (at 367) the irregular deposit is described as an 'anomalous category'.

<sup>17</sup> In general for real contracts in Roman law see Lee, above n 6 at 290–97; Nicholas, above n 5 at 167–71; and, in more detail, Zimmermann, above n 15 at 153–229. A fourth category of real contracts is the pledge (or *pignus*), under which a corporeal thing is handed over by one person to another as security for a debt.

Unlike the *mutuum* which, as discussed above, is a unilateral *stricti juris* contract fastening on the borrower an absolute duty, both the *commodatum* and *depositum* are *bonae fidei* and imperfectly bilateral contracts. Both confer on the transferee merely detention and not ownership in the object delivered to him, and an obligation to return the object in specie, which in specified circumstances may be excused. The *commodatum* is a gratuitous loan for use of an object, usually a chattel.<sup>18</sup> It might relate to fungible things, as long as the obligation to return is in specie. The borrower is bound to exercise the highest degree of diligence, and is thus liable even for slight negligence (*culpa levis in abstracto*). He is however not absolutely liable, and is released when loss has been caused by *force majeure*. For his part, the lender is required to allow the borrower to use the thing as agreed, to indemnify him for extraordinary expenses, and to indemnify him for damage caused by the thing lent owing to some defect of which the lender was aware.

Finally, the deposit is a contract under which one person, the depositor, gives to another, the depositary, a thing to be kept for him gratuitously and returned on demand. The depositary is not entitled to use the thing and is liable in its safekeeping for *dolus*, namely intentional wrongful act or bad faith, but not *culpa*, that is fault or negligence. He is also liable for *culpa lata*, or gross negligence, 'scarcely to be distinguished from *dolus*.'<sup>19</sup> In turn, the depositor is required to compensate the depositary for expenses as well as to indemnify him for all damage attributed to the depositor's *dolus* or *culpa*.

The exact juridical nature of the irregular deposit in Roman law has been a subject of a major scholarly controversy.<sup>20</sup> Even the process of its introduction from the Hellenistic East<sup>21</sup> and its recognition as a distinct concept<sup>22</sup> are not entirely clear. So far as strict classification is concerned, the irregular deposit is treated as a subcategory of deposit. A learned discussion supports that treatment of the irregular deposit already before the codification by Justinian.<sup>23</sup> Accordingly, with respect to the deposit of money, a distinction is made between the 'closed deposit', namely, the deposit of money in a sealed bag and the 'open deposit', namely the deposit of money otherwise than in a sealed bag. In the former case we have an ordinary deposit, giving rise to an obligation to return

<sup>18</sup> Where the loan of the chattel is for remuneration rather than gratuitous, the contract is for hire (or *location conductio*), which is classified as a consensual rather than real contract. See eg Lee, above n 6 at 320.

<sup>19</sup> Lee, *ibid* at 294.

<sup>20</sup> For a comprehensive overview see eg W Litewski, 'Le Dépôt Irrégulier', Part I (1974), 21 *Revue Internationale du Droit d'Auteur* 215, and Part II (1975), 22 *Revue Internationale du Droit d'Auteur* 279. See also WM Gordon, 'Observations on "Depositum Irregulare"' in *Studi in Onore di Arnaldo Biscardi* (Milano: Instituto Editoriale Cisalpino-La Goliardica, 1982) vol iii at 363. Litewski opens his study by stating that 'the irregular deposit constitutes one of the most controversial institutions in the science of Roman law'. Part I at 215 (my translation).

<sup>21</sup> See eg R Vigneron, 'Résistance du Droit Romain aux Influences Hellénistique: Le Cas du Dépôt Irrégulier' (1984), 31 *Revue Internationale du Droit d'Auteur* 307.

<sup>22</sup> Indeed, according to Andreau, *La Vie*, above n 1 at 533, the irregular deposit did not exist in the classical period of the Roman law, namely, during the second and third centuries CE.

<sup>23</sup> See summary of Litewski, above n 20 Part II at 31.

the sealed bag in specie. In the latter case we have the irregular deposit giving rise to the return of the amount of money deposited; and yet, its depositor is able to recover from the depositary under the same action available to a depositor seeking recovery in specie under a regular deposit.

At the same time, fundamental differences make the features of the irregular deposit closer to those of the *commodatum* and particularly the *mutuum*. Unlike the ordinary deposit, but like the *commodatum* and the *mutuum*, the irregular deposit allowed the depositary to use the thing. Furthermore, as in the *mutuum*, and unlike in both the *depositum* and the *commodatum*, in the irregular deposit, ownership of the thing passed to the depositary whose liability had been fastened in terms of the return of an equivalent amount of the thing. In fact, as already indicated above in chapter three, section 4, as a financial intermediary, an *argentarius* (namely a banker) was under no obligation to keep each deposit separately; instead, he typically mixed money deposited with him. Furthermore, he could use money on deposit for lending to third parties in his own name. He was thus not obligated to return in specie money deposited with him, but rather remained liable to each depositor to repay the amount of the deposit. He was not even required to return a deposit out of a pool of money constantly kept in his hands and earmarked to meet his liability to repay the amount of money deposited with him.

There is some controversy as to the precise point in which the depositary in an irregular deposit assumes the obligation of a borrower. Some suggest the time the use of the money by him has begun. Others regard the earlier point in time, of the mere delivery by the depositor, as the turning point.<sup>24</sup> It seems, though, that transfer of ownership, giving full authority to the depositary to use the money, occurs at the time of the 'open deposit', without any need to invoke specific authorization.<sup>25</sup> Conversely, for a deposit of money in a sealed bag to turn into an irregular deposit, a specific authorization must be given by the depositor to the depositary, upon which ownership in the money, together with the right to use it, passes to the depositary.

Nevertheless, as a matter of strict legal doctrine, Roman law has not fully recognized the irregular deposit as a *mutuum* or loan pure and simple. Certainly, in conferring title on the transferee and requiring restitution in genre rather than in specie, the irregular deposit differed from the *commodatum*. Furthermore, two fundamental distinctions exist between the *mutuum* and the irregular deposit which precluded the latter from being viewed as a subcategory of the former. First, the economic rationale of each transaction is different. Unlike the *mutuum*, the irregular deposit is 'a deposit made with a capitalist not a loan made by a capitalist.'<sup>26</sup> From the depositor's perspective, the principal

<sup>24</sup> For the diverse views on this point, see Litewski, *ibid* Part I at 218 and Part II at 280–81.

<sup>25</sup> In modern law *cf* eg in South Africa, *Ex parte Smith*, 1940 O.P.D. 120 at 126–27, per De Beer J, in effect rejecting 'the subtle distinction' between implicit and explicit authorization to use the money given to the depositary.

<sup>26</sup> Lee, above n 6 at 295.



objective of the irregular deposit is the safekeeping of money, rather than the economic gain from lending. Second, there are a few legal distinctions. Historically, particularly noted was the ability of the depositor, as opposed to the lender, to recover interest on the basis of a bare agreement, made at the time of the deposit, without the need to invoke to that end a formal stipulation.<sup>27</sup> Presumably, the latter difference stems from the bilateral and bona fide nature of the deposit; this nature bypassed the necessity of a formal obligation, without which nothing could be added to a unilateral *stricti juris* contract such as the *mutuum*.<sup>28</sup>

Paradoxically however, where an irregular deposit was payable with interest, it 'reconciled' with the *mutuum*, irrespective of the different basis for the claim to interest in each case; this was so at least with regard to the entitlement to recovery from an insolvent depositary-banker.<sup>29</sup> Thus, as a subcategory of the (regular) deposit, an irregular deposit payable without interest accorded the claimant priority over competing ordinary creditors of a depositary-banker; the claimant was accorded a lower priority than that conferred on a depositor of money in a sealed bag, but was nevertheless viewed as if attempting to recover the very thing actually deposited, and not merely its equivalent. Conversely, where the depositary-banker's repayment obligation was with interest, the advantage was lost also for the principal, so that the depositor was treated like an ordinary lender claiming for an equivalent amount of the money actually lent.<sup>30</sup> Different treatment was thus accorded to the irregular deposit, depending on whether it was repayable with or without interest; undoubtedly this split

<sup>27</sup> Stipulation is discussed at length further below in section 6 of this chapter. For the general validity of the *pacta adjecta*, namely, a simple agreement or pact annexed to some principal contract, intended to form part of it and to modify it, see Lee, *ibid* at 343. For the inapplicability of this rule to a 'bare pact' attached to a *mutuum*, see text at the note that follows. A 'pact' or 'bare pact' is an agreement which does not conform to any recognized category, and which in the absence of any recognized exception (such as the *pacta adjecta*), does not give ground to an action. *Ibid* at 342.

<sup>28</sup> For this explanation, see Zimmermann, above n 15 at 217, 218.

<sup>29</sup> Strictly speaking, the first of the two Digest texts cited in n 30 below, deals with the insolvency of *nummularii*, while the second with recovery from defaulting *mensularii*. For the *nummularii*, as a category of bankers in Rome see ch 3, section 4 above. According to Andreau, *La Vie*, above n 1 at 467, *mensulae* are the business premises of the *nummularii*. The Digest Editors (per cites in n 30 below) translated the former as 'moneylenders' and the latter as 'moneydealers'.

<sup>30</sup> For the depositor's priority and its limits see eg G Humbert, 'Argentarii' in C Daremberg and E Saglio (eds), *Dictionnaire Des Antiquités Grecques et Romaines* (Paris: Librairie Hachette, c1887; repr Graz: Akademische Druck-u. Verlagsanstalt, 1969) vol I Part 1 at 406, 407 (hereafter: Humbert, *Argentarii*). According to J Andreau, *Banking and Business in the Roman World*, trans by J Lloyd (Cambridge: Cambridge University Press, 1999) at 40 (hereafter: Andreau, *Banking*), 'interest-bearing deposits would legally be considered as loans.' See also Andreau, *La Vie* above n 1 at 533, 537. Two governing sources are Digest 16.3.7.2 and 42.5.24.2 respectively reproduced (in both Latin and English) in T Mommsen, P Krueger and A Watson (eds), *The Digest of Justinian* (Philadelphia: University of Pennsylvania Press, 1985) vol II at 473, and *ibid* vol IV at 553. The two texts may be reconciled to accord priority in the following order: depositors in sealed bags, preferred creditors, claimants on open deposits repayable with no interest, and the rest of the creditors, including on open deposits payable with interest. An extensive discussion is by P Cerami and A Petrucci, *Lezioni di Diritto Commerciale Romano* (Torino: Giappichelli, 2002) at 83–88 and 188–93 [in Italian] for which I had the benefit of a partial unofficial English translation.



treatment is inconsistent with a cohesive conceptualization of the irregular deposit.

In any event, so far as the allocation of risk is concerned, it seems to be accepted that as the owner of the money, the depositary under an irregular deposit, 'would naturally carry the risk of the money getting lost'.<sup>31</sup> Owing 'nothing except to pay an equivalent amount to that deposited to him',<sup>31.1</sup> he is under an absolute obligation to repay the amount of the deposit. At the same time, it is certainly the depositor who bears the risk of the depositary's insolvency, even if as a preferred creditor who prevails over other unsecured creditors; when the depositary used up all deposited money, there is nothing tangible belonging to the depositor which can be reclaimed in specie.<sup>32</sup> Accordingly, 'in modern law there is no practical difference' between the views treating the depositary's liability under the irregular deposit, either as a subcategory of deposit or as a species of *mutuum*.<sup>33</sup>

Viewing the depositary-banker as a borrower is consistent with recognizing his freedom to use the funds at his full discretion. This includes lending such funds in the banker's name, for his profit, and at his own risk. Historically, however, it was not always common for bankers to lend in their own name out of deposited funds. For example, as pointed out above in chapter three, section 5, bankers in Greco-Roman Egypt brokered loans by facilitating their occurrence out of funds on deposit, and yet directly by individual depositors. Risk of the borrower's default thus fell on each individual depositor-lender and not on the banker. In practice, money lent was withdrawn from depositor-lender's account and its sum was deducted from what was owed to him by the banker. Deposits were not segregated; funds placed by all depositors were amalgamated and the amount owed to each depositor was on an irregular deposit. Thus, the depositor's right against the banker was not in the form of a claim to specific coins and yet could have been seen as a claim to a share in the amalgamated fund. In case a banker became insolvent, each depositor could have been seen as equipped with a proprietary right to a share in whatever remained in the amalgamated fund, in preference to claims of unsecured creditors; as indicated above, this is consistent with the treatment of debts owed on an irregular deposit payable with no interest.<sup>33.1</sup> It would also have been consistent with the allocation of the risk of loss to the depositary-banker, albeit as a custodian and not a borrower. However, this interpretation would have meant that legal restrictions dictated bankers' conduct. Nevertheless, there is nothing to indicate the existence of a legal perception that precluded bankers in Greco-Roman Egypt from lending on their own out of money held on deposit; their omission to do so might have been purely economic. Stated otherwise, it appears that the existence of actual

<sup>31</sup> Zimmermann, above n 15 at 216.

<sup>31.1</sup> Digest, 19.2.31, reproduced in Mommsen et al, above n 30, vol II at 567.

<sup>32</sup> Digest 5.3.18, reproduced in Mommsen et al, *ibid* vol I at 186 where it is debated whether the possessor of an inheritance can pass to the heirs the loss of the proceeds of a sale of the inheritance deposited with the defaulting banker.

<sup>33</sup> Zimmermann, above n 15 at 219, fn 231.

<sup>33.1</sup> See text and n 30 above.

deposited coins in the hands of the Greco-Egyptian banker was not premised on rejecting the view that the depositor's claim against him was a mere claim for the repayment of an equal amount for which the banker was absolutely liable. In such a case, from a legal perspective, the banker was free to use the deposited money at its sole discretion and was liable to the depositor as if on *mutuum* and neither on *commodatum* nor on *depositum*.

Pothier, an eighteenth century French jurist, concluded<sup>34</sup> that from a strictly legal point of view, other than for the different motive or economic rationale underlying each transaction, the only remaining difference between the *mutuum* and the irregular deposit is the inability of a lender, in contrast to that of the depositor in an irregular deposit, to demand the money back immediately after delivering it. He recognized that both the irregular deposit and the money loan passed on the right to use the money together with the inherent risk of its loss. He was however of the view that in the irregular deposit, both the depositary's right to use the money, as well as the resulting transfer to him of the entire risk of loss or theft, are by-products of the fungibility of the money; that is, they both stem from the readiness of the depositor to be satisfied by the return in genre rather than in specie, and not from the basis of the transaction as in the money loan. He thus recognized the existence of both common and distinguishing elements between the irregular deposit and the money loan. Nevertheless, his overall conclusion was that, other than in theory, the depositary's liability in the irregular deposit is subject, in principle, to the same rules governing the money-borrower's liability.

Effectively then, Roman law chose to regard the obligation of the depositary of an irregular deposit, who has been authorized to use the deposited money to his own benefit, as that of a borrower on a loan. In hindsight, this choice looks superficially convincing. It is however submitted that there is a subtle flaw in Pothier's reasoning leading to this conclusion. Fungibility of money, and hence the depositor's readiness to be satisfied with restitution in genre, rather than in specie, explains the depositary's right to *mix* the deposited money instead of keeping it separate. It does not necessarily explain the depositary's right to *use* the money. Presumably, a depositor of money for safekeeping would be prepared to concede to the depositary the right to use the money only where the depositor is satisfied that there is no risk of the depositary's insolvency. A depositor for safekeeping, who is content with restitution in genre, and hence with the mixture of the deposited money, may nevertheless insist on the physical safekeeping of the money, whether in the form of an equivalent amount to be physically set aside or safely invested, or in the form of keeping in specie all money deposited by diverse depositors.

Indeed, a depositary's authority to use the money may have been accorded simply as a matter of convenience. Such authority was given by the depositor

<sup>34</sup> R.J. Pothier, 'Traité du Contrat de Dépôt' in M. Bugnet (ed), *Œuvres de Pothier*, 2nd edn (Paris: Henri Plon, Cosse et Marchal, 1861) vol V at paras 82–83.

merely as a way to save costs which would have otherwise been charged by a depositary strictly for safekeeping who would not have profited from the use of the money. At the same time, in giving this authority, the depositor incurred the depositary's insolvency risk, thereby compromising on the depositor's principal objective, that of safekeeping. To that end, it may be speculated that increasing the depositary's responsibility to the depositor from the limited one of a depositary for safekeeping to the absolute one of a borrower was unlikely to compensate for the risk of insolvency. Accordingly, notwithstanding Pothier's argument to the contrary, the authority to mix does not entail automatically the authority to use, without which *mutuum* does not exist.

It may be speculated that the depositary's right to lend out of an irregular deposit gradually evolved. Having been allowed to mix money on deposit, he ought not have been precluded from changing out of it; after all, money is fungible. Once he was allowed to deal with the money on deposit, it became only logical to treat him as its owner, so as to be able to use it to his sole benefit, and remain liable for its amount. Against the background of only nascent commercial banking, that is, in the absence of a large-scale lending out deposits, no particular financial risk may have been perceived. With full authority to use money on deposit, the depositary became a borrower, whose liability is nevertheless 'tainted' with some vestiges of that under his original function as a custodian for safekeeping, even if, ultimately, effectively only in the form of the classification of the action against him.

Possibly, the use of the irregular deposit also as a deposit of money with a friend, rather than necessarily with a financial intermediary,<sup>35</sup> facilitated the view that no insolvency risk was contemplated; hence, the deposit of money envisaged authority to use and not only to mix it. Accordingly, the depositor, having deposited money with a friend, having been indifferent to the identity of the actual coins to be returned to him and not being concerned with the depositary's solvency, was taken to be prepared to allow the depositary the unrestricted use of the deposited money. Yet, paradoxically, it is precisely this conclusion as to the legal effect of the irregular deposit as authorizing the depositary-friend to use the money which facilitated its application as the basis for the legal regime underlying the deposit of money with a bank as a financial intermediary.

### 3. THE LEGAL NATURE OF THE DELEGATION ORDER

Whatever **Paymaster's** relationship with **Debtor**, whether under a contract for money lent or money deposited, or otherwise, in acting under **Debtor's** order to pay, **Paymaster** appears to act under a mandate. In Roman law, the mandate is broadly defined as 'a contract whereby one person (mandator) gives another

<sup>35</sup> For the fact that in Rome the irregular deposit was not exclusively linked to the bank deposit, see Gordon, above, n 20 at 364. See also Pothier, *ibid* at para 82, referring to the irregular deposit as made by the depositor with 'one of his friends'.

(mandatary) a commission to do something for him'.<sup>36</sup> Originally, the service to be performed under the mandate must have been performed gratuitously. Indeed, under Roman law, services could have been performed for a reward, in which case, the contract was for hire and not a mandate. However, a contract for hire, whether for services (*locatio conductio operarum*) or work (*locatio conductio operis*),<sup>37</sup> was quite limited in its scope: '[i]t was generally limited to services which were commonly rendered by slaves.' Conversely, '[m]embers of what are called the liberal professions were supposed to do their work for nothing.'<sup>38</sup> Hence the inappropriateness of the contract for hire, the need for the mandate as another type of contract, as well as the gratuitous nature of the mandate. With the passage of time, the gratuitous nature of the mandate became a matter of mere form, with the mandatary becoming entitled to an agreed honorarium, which he could claim under a separate action, without being allowed to raise that entitlement by way of defence to a mandator's action against him.<sup>39</sup>

While the word 'mandate' suggests a 'command', the mandate may not be created by the mandator unilaterally. Rather, the mandate is a bilateral, and hence a *bonae fidei*, contract. It is a consensual contract, which derives its validity from the mere agreement of the parties or, more specifically, from the acceptance by the mandatary of the mandator's instructions directed to him to carry out the task; validity does not stem from the use of any formal language or the physical delivery of any object. The mandate is thus not a real, verbal, or literal contract. By the same token, it is an informal contract, whose validity does not depend on form; its conclusion does not even require a face-to-face meeting, as it may be concluded by letter or by messenger.<sup>40</sup>

As for the mutual obligations of the parties, '[m]andate was imperfectly bilateral, the [mandatary] being bound to perform the service, and the [mandator] being contingently bound to indemnify him for his expenses. The [mandatary] was also bound to account to the [mandator] for any incidental benefits he derived from the performance of the service.'<sup>41</sup> In performing the service the

<sup>36</sup> See eg Lee, above n 6 at 334. A detailed monograph is A Watson, *Contract of Mandate in Roman Law* (Oxford: Clarendon Press, 1961).

<sup>37</sup> Briefly stated, the distinction between these two types of the contract for hire is as follows: while the subject-matter of the former (*operarum*) is the services themselves, the subject-matter of the latter (*operis*) is the result accomplished by the services. See eg R Zimmermann, above n 15 at 394. A third category of the contract for hire was the hire of a thing (*locatio conductio rei*). For all three categories see Lee *ibid* at 320–21.

<sup>38</sup> Lee, *ibid* at 321. See also at 320, 335, as well as Zimmermann, *ibid* at 390, 413.

<sup>39</sup> See Nicholas, above n 5 at 188. The separate action was a claim for *cognitio extraordinaria* before the magistrate. See JAC Thomas, *The Institutes of Justinian: Text, Translation and Commentary* (Amsterdam-Oxford: North Holland Pub Co, 1975) at 246 (Commentary on Institutes Book III, Title XXVI) (hereafter: Thomas, *Institutes*). For this 'latest form of civil proceedings' see in general, Berger, above n 2 at 394 (v, '*cognitio extra ordinem (extraordinaria)*').

<sup>40</sup> Lee, above n 6 at 307. For classification of contracts see concluding paragraphs in section 1 above.

<sup>41</sup> See Nicholas, above n 5 at 187. A contract in which 'the duties of one party are only contingent' is said to be 'imperfectly bilateral (or semi-bilateral).' See Lee, *ibid* at 169, fn 1.

mandatary was liable for *dolus*,<sup>42</sup> namely, an intentional wrongful act,<sup>43</sup> or breach of good faith.<sup>44</sup> An exclusion of liability for *dolus* was disapproved of as being contrary to good morals.<sup>45</sup>

In principle, the service performed under a mandate might be of any kind; however, it commonly consisted of entering into a contract or some other legal transaction with a third party.<sup>46</sup> At first blush, the order under the delegation looks as though it creates a mandate. From this perspective, **Debtor**, the delegant, as a mandator, instructs **Paymaster**, the delegated person, as a mandatary, to act for him (**Debtor**) by assuming and performing his (the delegant-**Debtor**'s) obligation to the third party, **Creditor** (**Debtor**-delegant-mandator's creditor). Being a bilateral contract, the mandate relationship is thus created upon the agreement of **Paymaster**, the delegated person, as a mandatary, to perform **Debtor**'s, the delegant-mandator's, obligation, as instructed. It is however noteworthy that notwithstanding the wide scope of the mandate in Roman law, the order to pay has not featured in leading texts among the examples set out for the mandate. In fact, resort to the mandate as the framework for analysing the payment order, which is the modern approach of civil law countries whose legal tradition is founded on Roman law,<sup>47</sup> does not appear to derive from a direct classic precedent.<sup>48</sup>

Indeed, while the view that the delegation order constitutes a mandate is not without some support,<sup>49</sup> mandate has been 'rarely used' for delegation,<sup>50</sup> which has been characterized as being 'untechnically' a mandate.<sup>51</sup> Rather, the delegation has been viewed as a *jussus*, or order, that unlike the mandate which is truly

<sup>42</sup> Lee, *ibid* at 335.

<sup>43</sup> *Ibid* at 287.

<sup>44</sup> Zimmermann, above n 15 at 210.

<sup>45</sup> See Zimmermann, *ibid* at 712. See also Lee, above n 6 at 287. Over the years, the mandatary's liability has been expanded to cover negligence. In turn, generally speaking, under present-day civil codes, gross negligence (as opposed to light negligence) cannot be contracted out. See discussion by Zimmermann, *ibid* at 426–30. For the proximity between gross negligence (*culpa lata*) and *dolus*, see Nicholas, above n 5 at 170; Lee, *ibid* at 294 and Zimmermann, *ibid* at 209.

<sup>46</sup> Nicholas, above n 5 at 187. See also the following quote from Zimmermann, above n 15 at 421 which is instructive: 'Mandate . . . covered a wide range of situations. The mandator could request the mandatary to clean clothes, to build a tomb or to engage in any other (factual) activity. Usually, however, the mandatary was asked to enter into a contractual relationship with a third party: be it that the mandator wanted him to lend or borrow money, to stand surety, to buy or sell a farm or to let or hire a slave.'

<sup>47</sup> For the mandate doctrine application to the order to pay under major present-day civil codes see B Geva, *Bank Collections and Payment Transactions: Comparative Study of Legal Aspects* (Oxford: Oxford University Press, 2001) at 89 *et seq.* In this book see ch 12, section 5 below.

<sup>48</sup> For support, based also on extensive analysis of classical texts, see Rutsaert, above n 2 at 35–100, whose textual analysis is rejected by G Hubrecht, 'Mouvement des Idées et Bibliographie' (1931), 55 *Revue Générale du Droit, la Legislation et la Jurisprudence en France et à l'Étranger* 229 (Pt I), and 304 (Pt II). Occasional references in the sources are explained away by Maxwell, in the course of his comprehensive discussion, above n 2 at 7–31 on the delegation as a mandate. In the course of the discussion, Maxwell sets out (though ultimately rejects) views supporting the analysis of the delegation as a mandate.

<sup>49</sup> *Ibid.*

<sup>50</sup> Roby, above n 2 at 42–43.

<sup>51</sup> Dannenbring, above n 2 at 269.

‘a contract’, is ‘a one-sided declaration of will’,<sup>52</sup> issued by the order giver to someone ‘under his power’,<sup>53</sup> namely with whom he has already been in a pre-existing relationship.

True, unlike the typical mandator, typical delegant-**Debtor** is in a pre-existing relationship with **Paymaster**, usually that of a debtor and creditor.<sup>54</sup> By itself however, this has not been taken to eliminate the need for **Paymaster**’s consent for an effective delegation to be carried out. Three principal substantive objections to the characterization of the delegation as a mandate have nevertheless been raised.<sup>55</sup> They can be summarized as follows. *First*, in a mandate, the mandatary (**Paymaster**) may be sued by the mandator (**Debtor**). In contrast, in a delegation, the person to be delegated (**Paymaster**) may not be sued by the delegant (**Debtor**) for the failure to perform. *Second*, upon the execution of a mandate, it is the mandatary (**Paymaster**) and not the mandator (**Debtor**) who stands in direct privity with the third party (**Creditor**); the mandatary (**Paymaster**) is then obligated to pass on acquired benefits and incurred burdens to the mandator (**Debtor**). In contrast, upon carrying out a delegation by the person delegated (**Paymaster**), the benefit of the discharge is conferred directly on the delegant (**Debtor**). *Third*, a mandatary (**Paymaster**) is not to incur any benefit from the execution of the mandate, which ought to be exclusively for the benefit of the mandator (**Debtor**). In contrast, in a delegation occurring in circumstances under which the person to be delegated (**Paymaster**) owes the delegant (**Debtor**), the execution of the delegation confers a benefit on the person delegated (**Paymaster**) in the form of his discharge towards the delegant (**Debtor**).<sup>56</sup>

Appealing as they are, these objections can nonetheless be met as follows. With respect to the *first objection*, it is true that, being bound by contract, a mandatary is obligated to perform the service, which is not the case for the person instructed to act under the one-sided declaration of will under the *jussus*.

<sup>52</sup> Roby, above n 2 at 122.

<sup>53</sup> Berger, above n 2 at 534, v. ‘*Iussum*’.

<sup>54</sup> A point highlighted eg by Hubrecht, above n 48 particularly at 309–13. But there is nothing to preclude a delegation order issued to a complete stranger, who by accepting it will become both liable to and entitled from **Debtor**. Elsewhere Hubrecht acknowledges that in the absence of a pre-existing relationship between **Debtor** and **Paymaster** the delegation order is a mandate. See G Hubrecht, *Manuel de Droit Romain Tome II: Les Obligations* (Paris: R Pichon et R Durand-Auzias, 1943) at 221. The distinction appears however to be quite tenuous if not unconvincing: cf paragraph containing nn 57–58 below (meeting the first objections).

<sup>55</sup> For a comprehensive discussion of the delegation as a mandate, see Maxwell, above n 2 at 7–31. See also Lanata, above n 2 at 24–30. See also Gide, above n 2 at 458–80, and particularly at 474–76, who distinguishes between the mandate and *jussus* and concludes that the delegation is the latter and not the former.

<sup>56</sup> Badareu ‘Tomsa’, who does not mention this objection, raises another one, namely, that while the mandate is available for a physical as well as a juridical act, the *jussus* merely involves the exercise of legal power, namely is exclusively available for a juridical act. Above n 3 at 18. However, the response to this objection appears to me to be self evident, as the author does not negate the possibility that a mandate is available for a juridical act as well; hence it does not follow that the mandate does not cover the delegation.

To that end, an 'authorization' under the *jussus*, may be viewed as a mere permission rather than an order; it thus appears to fall short of a mandate. Nevertheless, the distinction does not have much efficacy; it is in performing or commencing performance, that is, either by making payment or becoming bound by his agreement to **Creditor**, that **Paymaster** renders **Debtor's** mandate to him both irrevocable (by **Debtor**) and non-withdrawable (by **Paymaster**).<sup>57</sup> Stated otherwise, a mandatary who received an 'order' but who has not commenced to perform is free to withdraw, and one who received only 'permission' to act becomes a mandatary upon his commencement to perform.<sup>58</sup>

As for the *second objection*, indeed, the mandate does not operate to confer the benefit of the 'commission' directly on the mandator; rather, Roman law adheres to strict privity requirements and resists any theory conferring rights on a non-party to a contract.<sup>59</sup> To that end, legal doctrine does not facilitate direct representation of modern agency law. In other words, a contract entered with a third party by the mandatary burdens and benefits the mandatary, not the mandator, no matter that the contract with the third party was entered by the mandatary in carrying out his commission for the mandator. Having carried out his commission under the mandate, the mandatary is required to pass on the benefit, and the attached burdens, to the mandator.<sup>60</sup> Nevertheless, under Roman law, the performance of a contract, including the payment of a debt, might be made not only by the debtor but also by someone else purporting to act on his behalf;<sup>61</sup> 'It does not matter who pays a debt: neither the knowledge nor the consent of the debtor is necessary for his discharge, provided it is paid on the debtor's account.'<sup>62</sup> Hence, payment by the mandatary-**Paymaster** to **Creditor**, the creditor of the mandator-**Debtor**, in the commission of the mandate, discharges **Debtor** towards **Creditor** so as to benefit directly **Debtor**, irrespective of and outside any mandate doctrine.

The *third objection* related to the benefit conferred on the **Paymaster** by carrying out payment. Indeed, it is true that in the performance of the mandate, a

<sup>57</sup> Lee, above n 6 at 334–36 and Nicholas, above n 5 at 187. In fact the point may be seen as conceded by Maxwell; while citing lack of liability of the person to be delegated to the delegator as the basis for rejecting the application of mandate and supporting that of *jussus*, (above n 2, particularly at 14 and 28) he explicitly rejects, albeit without explaining, any distinction between a mere 'authorization' and an 'order'. *Ibid* at 28.

<sup>58</sup> Arguably then, *jussus* is relevant only in those situations where the order receiver is incapable of acting as a mandatary, as eg in relation to an order given by a father or master, in which case, in executing the order, a direct relationship is established between the order giver and the third party. Cf Roby, above n 2 at 122–23.

<sup>59</sup> Hence the maxim 'no acquisition to us through an outsider'. See *The Institutes of Gaius*, Book II §95. See eg the translation by WM Gordon and OF Robinson, *The Institutes of Gaius* (Ithaca: Cornell, 1988) at 167–69. For 'the obligatio as being a strictly personal bond between the two parties who had concluded the contract' as precluding Roman law from recognizing 'contracts in favour of third parties' see Zimmermann, above n 15 at 34. For the rule and its subsequent erosion see *ibid* at 34–45 and Lee, above n 6 at 353–58. But cf n 77 below.

<sup>60</sup> See Zimmermann, *ibid* at 421, and on the rule and its erosion at 45–58 and Lee, *ibid* at 358–66.

<sup>61</sup> See Lee, *ibid* at 413, 415.

<sup>62</sup> Roby, above n 2 at 50.



mandatary is to act exclusively for the benefit of the mandator.<sup>63</sup> At first blush, the discharge of **Paymaster** as a mandatary towards his mandator-**Debtor** appears to be a benefit conferred on **Paymaster** as a result of acting on the mandate. However, upon carrying out the service, namely, the payment to **Creditor**, **Paymaster**, as a mandatary, becomes entitled to be indemnified from the mandator-**Debtor**.<sup>64</sup> The discharge of the pre-existing debt owed by **Paymaster** to **Debtor**, such as under money lent or deposited, may then be viewed not as a benefit conferred on **Paymaster** for carrying out **Debtor**'s mandate. Rather, **Paymaster**'s discharge could be viewed as resulting from the use of the pre-existing debt owed by **Paymaster** to **Debtor**, by way of offset or 'compensation', effectively to extinguish the debt owed by **Debtor** to **Paymaster** for the indemnification of **Paymaster**. Indemnification of **Paymaster** is for his expenditure incurred in the payment to **Creditor** as instructed under the mandate.<sup>65</sup> Stated otherwise, under this analysis, in making the payment to the third party **Creditor**, the mandatary **Paymaster** is to be seen as acting for the mandator **Debtor**, conferring on **Debtor** the benefit of discharge against the third party **Creditor**. From this perspective, laying a claim for reimbursement, which is to be satisfied by the discharge of the mandatary **Paymaster**'s own debt to the mandator **Debtor**, is thus quite consistent with mandate doctrine. In other words, it is the exercise of the right of setoff and not the execution of the mandate which benefits **Paymaster**.

The difficulty with this explanation to the third objection is that in connection with bilateral, and hence *bonae fidei*, contracts, such as the mandate,<sup>66</sup> classical law permitted the offset between mutual obligations only when they arose from the same transaction,<sup>67</sup> which is obviously not the case with respect to **Paymaster**'s pre-existing debt to **Debtor** and **Paymaster**'s claim against **Debtor** on the basis of the execution of the mandate. This limitation may have been abandoned towards the end of the classical era,<sup>68</sup> but nevertheless was not repealed by Justinian.<sup>69</sup>

Compensation was however available against an *argentari*, namely a banker, who in suing his debtor on a debt owed by the debtor to the banker was required

<sup>63</sup> In general, a mandatary had to act gratuitously and was bound 'to make over to the mandator all benefits accruing from the mandate'. See eg Lee, above n 6 at 335.

<sup>64</sup> In the absence of an express mandate, indemnification by **Paymaster** from **Debtor** may have been under quasi contract or unjust enrichment, generally discussed by Lee, *ibid* at 374–66, Nicholas, above n 5 at 227–33 and at greater length by Zimmermann, above n 15 at 834–87. Lee, *ibid* at 334, 372, effectively speaks of the extension of mandate doctrine to cover such cases.

<sup>65</sup> For *compensatio* in Roman law in relation to modern law see Zimmermann, above n 15 at 760–67. See also Comment by ME Tigar, 'Automatic Exinctions of Cross-Demands: *Compensatio* from Rome to California' (1965), 53 *California Law Review* 224, particularly on the Roman origins, at 226–34.

<sup>66</sup> For this nature of the mandate see text in paragraph containing n 40 above. For classification of contracts see concluding paragraphs in section 1 above.

<sup>67</sup> Thomas, *Institutes* above n 39 at 297 (Commentary on Institutes Book IV, Title VI).

<sup>68</sup> Zimmermann, above n 15 at 767.

<sup>69</sup> See Justinian's Institutes Book IV, Title VI, paras 30 and 39, reproduced in Thomas, *Institutes* above n 39 at 288, 291, and discussed by Lee, above n 6 at 466.



to offset an amount the banker owed the debtor.<sup>70</sup> This appears to include the offset, against the claim of the banker (as **Paymaster**) for the execution by him of the customer's payment order, of the amount of the pre-existing debt owed by the banker to the customer.

Under such circumstances compensation worked also<sup>71</sup> where the obligation of the debtor-customer (**Debtor**) arose from his acknowledgement of a book-keeping entry. Such an entry denoted the payment by the banker (**Paymaster**) to **Creditor**, made by the creditor-banker (**Paymaster**) to his ledger. In such a case, in claiming from the customer the amount of the entry, the banker was required to offset the amount he owed the customer. Compensation worked then notwithstanding the *stricti juris* and hence unilateral nature of the resulting literal contract.<sup>72</sup>

This offset had to be exercised by the plaintiff-banker in establishing the amount to be claimed; it could not be exercised by the defendant customer in defending the banker's action. Furthermore, this offset was stated to be available to reduce the amount of the banker's action against the customer, but not vice versa, in reduction of the amount of the customer's action against the bank.<sup>73</sup>

Indeed, compensation against an obligation on a *stricti juris* contract was expanded by Emperor Marcus Aurelius (161–180 CE).<sup>74</sup> Thereafter, in an action by a customer, who in stating the amount owed by the banker did not deduct what he owed to the banker, the banker could invoke fraud; thereby the banker could effectively offset against the customer what the customer owed to the banker, as for example, in satisfaction of the banker's claim for reimbursement for carrying out payment on behalf of the customer. As well, parties owing to each other under a series of literal contracts could in any case strike a balance to reflect one amount owed between them.<sup>75</sup>

In any event, the book-keeping system, giving rise to a *stricti juris* literal contract between a banker and his customer, further discussed in section 7.2

<sup>70</sup> This is based on Gaius' Institutes, Book IV §64, Gordon and Robinson, above n 59 at 453–55.

<sup>71</sup> The banker's claim did not necessarily arise from a *stricti juris* contract. See discussion on bank account books (*rationes*) at the end of section 7.2 below. There is nothing in Gaius' text, *ibid*, to limit the compensation against banker to a banker's claim on a *stricti juris* contract.

<sup>72</sup> Thomas, *Institutes* above n 39 at 297 (Commentary on Justinian's Institutes Book IV, Title VI). For classes of contract see concluding paragraphs in section 1 above.

<sup>73</sup> For a detailed discussion on this banker's compensation obligation see P Pichonnaz, *La Compensation* (Fribourg: Éditions Universitaire Fribourg Suisse, 2001) at 127–67. Compensation is set out in Gaius' Institutes Book IV §§61–68, Gordon and Robinson, above n 59 at 451–55. See also F De Zulueta, *The Institutes of Gaius*, Part I: Text with Critical Notes and Translation (Oxford: Clarendon Press, 1946) at 261–63 and Part II: Commentary (Oxford: Clarendon Press, 1953) at 266–68. Gaius' own example in §64, Zulueta, Part I, *ibid* at 261 is as follows: 'if a banker owes Titus 10,000 sesterces and Titus owes him 20,000, the banker's *intentio* will run: "if it appears that Titus ought to pay the plaintiff 10,000 sesterces more than the plaintiff owes Titus."' Stated otherwise, the banker's claim is limited to the amount in which his claim is higher than that of the customer.

<sup>74</sup> Thomas, *Institutes* above n 39 at 297 (Commentary on Justinian's Institutes Book IV, Title VI). For a detailed discussion on compensation against a claim on a *stricti juris* contract see eg CI Appelton, *Histoire de la Compensation en Droit Romain* (Paris: G Masson, 1895) at 92–155.

<sup>75</sup> See discussion at the end of section 7.2 below.

below, became obsolete way back in the classical period. The expansion of compensation against an obligation on a *stricti juris* contract has thus become irrelevant in attempting to rationalize the discharge of **Paymaster**, as a banker, towards **Debtor**, as his customer. Furthermore, **Paymaster** is not always a banker, and as explained, even as against a banker compensation does not always work. In the final analysis, the role of compensation in explaining **Paymaster's** discharge is limited to its availability in the circumstances in which it could be applied.

An alternative reply to the third objection, not based on compensation, is thus that payment by **Paymaster** to **Creditor** is to be regarded as both in execution of **Debtor's** mandate, as well as in the performance of **Paymaster's** own obligation to **Debtor**. Accordingly, in obtaining his discharge from **Debtor**, strictly speaking, **Paymaster** does not benefit from the execution of the mandate, but rather from **Debtor's** acceptance of the substituted performance, *datio in solutum* of **Paymaster's** obligation to him.<sup>76</sup>

It is however conceded that the application of the mandate theory to the delegation is not all that straightforward. Nor is mandate doctrine adequate to explain the legal position, of both **Debtor** and **Paymaster**, towards **Creditor**, upon compliance by **Paymaster** other than by prompt payment. In other words, mandate doctrine does not explain the legal position of both **Debtor** and **Paymaster** towards **Creditor** upon acceptance by **Paymaster** of **Debtor's** instructions, that is, upon **Paymaster's** agreement to abide by them. More generally, mandate doctrine is unable to explain the nature of the debt owed by **Paymaster** to **Creditor** in the course of the operation of the payment mechanism, and its impact on the debts owed by **Debtor** to **Creditor** and **Paymaster** to **Creditor**. At the same time, as discussed above, mandate doctrine remains a most satisfactory framework for analysing the mutual obligations between the mandator **Debtor** and the mandatory **Paymaster**; at least for the modern lawyer, reservations to the contrary are much in the nature of hair-splitting. In the final analysis, then, at least in hindsight, the delegation order can fairly be characterized as a mandate; yet, mandate doctrine is too narrow to explain all the legal ramifications arising in the course of the execution of the delegation order.

#### 4. EXECUTING THE DELEGATION: INTRODUCTION

As discussed, on agreeing with **Debtor** to pay **Creditor**, namely, upon his acceptance of **Debtor's** order or, more specifically, upon commencing execution, **Paymaster** may be seen as a mandatory bound by the mandate, albeit only

<sup>76</sup> For discharging an obligation other than by performance to which 'the debtor was bound to render to the creditor', but rather, by means of 'something which the creditor was willing to accept in its place (*datio in solutum* – substituted performance)' see in general, Lee, above n 6 at 412–13. See also Berger, above n 2 at 425.

towards the mandator-Debtor.<sup>77</sup> At the same time, in the context of delegation, acceptance, or agreement by **Paymaster** (the delegated person) is constituted by either performance (*'datio'*)<sup>78</sup> or incurring liability to delegatee-Creditor; either way it is one step beyond **Paymaster's** mere agreement to abide by the mandate given by Debtor. **Paymaster's** acceptance towards Creditor thus requires an additional procedure and generates a contract of its own.

Certainly, Creditor could have appointed **Paymaster** to receive payment from Debtor. Creditor's appointment or authorization could be for the specific payment or for all incoming payments in his favour; in each such case **Paymaster** would be acting as Creditor's mandatary to receive payment. For example, **Paymaster** could be an *argentarius* (banker) for both Debtor and Creditor, complying with Debtor's payment order by posting a debit entry to Debtor's account and a corresponding credit entry to Creditor's account.<sup>79</sup> Or else, as an *argentarius* for Creditor only, **Paymaster** could be receiving a sum of money from Debtor in favour of Creditor.<sup>80</sup> In such cases, no additional act of acceptance is required to effect **Paymaster's** engagement to Creditor and the discharge of Debtor to Creditor; both are dispensed with on the basis of Creditor's mandate to or authorization of **Paymaster** to receive payment on Creditor's behalf.

In all other circumstances, as discussed, where **Paymaster** owes Debtor who owes Creditor, **Paymaster's** acceptance by performance, through payment to Creditor, in fact discharges both debts. In the process, **Paymaster** does not incur liability to Creditor. At the same time, acceptance of **Paymaster** by agreeing to pay Creditor, other than when he has been acting as a mandatary for Creditor, may give rise to **Paymaster's** liability to Creditor in several ways. An analysis of the legal nature of **Paymaster's** acceptance or binding agreement to execute Debtor's order revolves around two principal issues. First, there is the question of the requirements to be met for such an agreement to exist and be enforceable by Creditor. Second, there is a question of the scope of **Paymaster's** undertaking under that agreement towards Creditor, and its impact on the original obligations owed by Debtor to Creditor as well as by **Paymaster** to Debtor. For each such

<sup>77</sup> For a comprehensive examination of the possibility that **Paymaster's** acceptance of Debtor's delegation order confers a right on Creditor, see Rutsaert above n 2 at 100–32. While (contrary to the orthodox view cited in n 59 above) not ruling out the possible effectiveness of a contract for the benefit of a third party, already way back under classical law, Rutsaert nevertheless does not conclude that **Paymaster's** acceptance of Debtor's order is typically such a contract, and further highlights lack of direct authorities in classical law on this point.

<sup>78</sup> See Berger, above n 2 at 424, v. *'dare'* and *'datio'*.

<sup>79</sup> For the banker's records and procedures in posting the entries see end of section 7.2 below. A modern lawyer's question as to whether irrevocability and hence accountability by **Paymaster** to Creditor has been achieved earlier in the banking process of complying with Debtor's order and posting the entries does not seem to be dealt with and may be anachronistic. The situation in which Debtor and Creditor employed different bankers is more complex and is discussed in section 10.3 below.

<sup>80</sup> In such a case, Creditor may be seen as willing to accept, in performance of Debtor's payment obligation to him, a substituted performance – *datio in solutum* – of payment by Debtor to **Paymaster**.

question, discussion under Roman law is in the context of an obligation derived from one of a few alternative types of contracts for the execution of the delegation.<sup>81</sup>

In fact, the two issues underlying the legal nature of **Paymaster's** undertaking triggered by his acceptance of **Debtor's** order are quite related; it is the type of **Paymaster's** agreement that determines both its scope and whether **Debtor's** obligation to **Creditor** continues to subsist. To that end, a principal distinction lies between cases of an imperfect and perfect execution of the delegation. It is only where **Debtor** is discharged towards **Creditor** upon **Paymaster's** acceptance and the resulting undertaking to pay **Creditor**, that the delegation is said to be perfect.<sup>82</sup>

In the final analysis, however, in dealing with the impact of **Paymaster's** undertaking to pay **Creditor** the debt owed by **Debtor** to **Creditor**, the choice in Roman law has been between the continued existence of the debt owed by **Debtor** to **Creditor** in an imperfect execution of the delegation and the extinction or discharge of this debt in the perfect execution of the delegation. No middle ground for suspension or conditional discharge of **Debtor**, until default by **Paymaster**, appears to exist or even to have been considered.

## 5. IMPERFECT EXECUTION: *RECEPTUM* AND *CONSTITUTUM*

Up to the time of Justinian,<sup>83</sup> there were two distinct avenues<sup>84</sup> for carrying out an execution of the delegation which was likely to be characterized as imperfect: *receptum argentarii* and *constitutum debiti alieni*.<sup>85</sup> There is a controversy as to the nature of the former as a formal literal contract, a formal verbal contract,<sup>86</sup> or of formless Praetorian origin, as the latter most likely was.<sup>87</sup>

<sup>81</sup> The most comprehensive discussion is by Maxwell, above n 2 at 53–66.

<sup>82</sup> The distinction draws on Maxwell, *ibid* at 66. For a detailed discussion effectively demonstrating that classical texts do not limit delegation to instances in which the acceptance by **Paymaster** of **Debtor's** order entails the discharge of **Debtor** towards **Creditor** see Rutsaert, above n 2 at 11–34.

<sup>83</sup> Reform projects of Justinian and their impact are set out in section 8 below.

<sup>84</sup> But see E. Guillard, *Les Banquiers Athéniens et Romaines suivis du Pacte de Constitut en Droit Romain* (Paris, Lyon: Guillaumin, H. Georg, 1875), who (contrary to all) appears to challenge the distinct nature of each avenue by maintaining (at 114) that the *receptum* is a *constitut* emanating from a banker.

<sup>85</sup> See Berger, above n 2 at 668, 410, and Lee, above n 6 at 343, 367. For a concise review covering both see Thomas, *Institutes*, above n 39 at 248–49 (Commentary on Justinian's Institutes Book III, Title XXVI).

<sup>86</sup> For classes of contract see concluding paragraphs in section 1 above.

<sup>87</sup> More specifically, the latter is an *actio in factum*; for such an action there is no civil law precedent. For the particular function of the Praetor and his role in expanding and adapting civil liability in Roman Law, see in general Nicholas, above n 5 at 23–28, Lee, above n 6 at 433–35, and Berger, above n 2 at 347 (v. '*Actiones praetoriae*'). An adapted (as opposed to a newly added) praetorian action is discussed below in text and n 229 as well as in n 239. For the *constitutum debiti* as a form of *Pacta Praetoriana*, see eg Lee, *ibid* at 343. Strictly speaking, a pact can be used solely by way of shield and not sword; that is, it may serve as a basis of a defence to an action but not as the basis of an action. 'Progressively, however, certain Pacts were made actionable.' Lee, *ibid* at 342.

*Receptum argentarii*<sup>88</sup> is limited to the case of a promise undertaken by a banker (*argentarius*),<sup>89</sup> acting under the instruction of his client (*Debtor*), to perform towards a third party (*Creditor*), on a fixed date. The promise is not limited to the payment of a monetary debt; its potential scope is thus unlimited.<sup>90</sup> The undertaking is a form of accommodation by a banker, acting (in connection with a promise to pay money) as *Paymaster* for the client *Debtor*. The banker-*Paymaster*'s undertaking is enforceable by *Creditor* by means of an *actio receptia*, and stands on its own; it is effective towards the third party (*Creditor*) even in the absence of a pre-existing undertaking of the client *Debtor* to the third party *Creditor*. Moreover, where accommodation is given by *Paymaster* to support a pre-existing *Debtor*'s obligation to *Creditor*, the banker-*Paymaster*'s obligation is entirely autonomous, namely, free of defences that may have been available to *Debtor* against *Creditor*; it is enforceable by *Creditor* against *Paymaster* even when *Debtor*'s obligation to *Creditor* was invalid.<sup>91</sup> At the same time, the banker-*Paymaster*'s undertaking to *Creditor* does not impact *Debtor*'s own original obligation to *Creditor*, where the latter existed; that is, until satisfaction, both obligations to *Creditor*, that of *Debtor* and *Paymaster*, exist side by side, and are enforceable by *Creditor*.

The *constitutum debiti alieni* is a specie of *constitutum*.<sup>92</sup> The *constitutum* is not limited to a banker (*argentarius*) and may be given by any person. At its inception it was limited to an obligation to pay a certain sum of money, and subsequently expanded to cover an obligation to deliver a quantified amount of fungible items, namely items that can be measured, counted, or weighed. However, certainty of the amount, either of money or the fungible subject matter, has remained a pre-requisite. The *constitutum* is a promise to pay an existing debt on a stated date and at a stated place; the existing debt is either that of the promisor or of another party. The former is a case of *constitutum proprii* and the latter is that of *constitutum debiti alieni*. In either case, the sum so promised is called *pecunia constituta* and accordingly, the action to enforce the promise,

<sup>88</sup> For a comprehensive discussion, see G Platon, *Les Banquiers dans la Législation de Justinien* (Première Partie) (Paris: Librairie Recueil Sirey, 1912) ch II: Le 'Receptum argentarii' at 43, as well as subsequent chapters, dealing with the relationship between the *receptum argentarii* and various other legal obligations. A recent account is by Cerami and Petrucci, above n 30 at 104–11.

<sup>89</sup> As of the second or third century CE *receptum argentarii* could also be taken by another class of bankers, called the *nummularii*. See Andreau, *Banking* above n 30 at 43. For classes of bankers in the Roman world see ch 3, section 4 above.

<sup>90</sup> 'Everything which could be the object of an agreement between individuals could fall under the *receptio argentarii*: chattels, animals, fields, homes'. Platon, above n 88 at 46 (free translation). See also at 48.

<sup>91</sup> Or else, as put by Platon, *ibid* at 46, the *receptum* does not require any 'causa' (a term referred to in n 10 above); it thus stands on its own absolute or abstract terms. It is also logical to conclude that the banker-*Paymaster*'s promise to the third party *Creditor* is not supported by any collateral security given to *Creditor* by the client-*Debtor* to support his own obligation.

<sup>92</sup> See Berger, above n 2 at 410; H Coulon, *Droit Romain: Du Constitut Debiti Alieni* (Poitiers: Typographie Oudin, 1889); A Philippin, *Le Pacte de Constitut – Actio de Pecunia Constituta* (Paris: Duchemin, 1929); and J Déjardin, *L'Action Pecuniae Constitutae* (Paris: Rousseau, 1914). See also Platon, *ibid* at 164, ch V *bis*, 'Histoire et Rôle du Constitut'; and Guillard, above n 84 at 104–30.

is *actio de pecunia constituta*. A debtor sued on the *constitutum* could be required, and was entitled to require the plaintiff, to formally undertake the payment of a penalty in the amount of one half of that of the original debt upon losing the case.<sup>93</sup> Presumably, however, this penalty could be exacted only in *constitutum proprii* and not in *constitutum debiti alieni*.<sup>94</sup> In any event, an obligation on a *constitutum* is subject to an immediate execution or payment without any delay and is thus advantageous to a creditor.<sup>95</sup>

The promise given under the *constitutum* is that of an assurance as to the availability to the creditor on a due date of the sum owed under the original debt. No formal requirements are to be met in order for the promise to be binding; it could be given orally, in writing, *in abstentia*, or by sending a messenger. However, most frequently, it was given by means of a letter sent (rather than directly delivered) by the promisor.<sup>96</sup> The rationale underlying the *constitutum* promise was once identified with the extension given to a defaulting debtor. The broader and better rationale is that of any modification to the promise to pay an existing debt, other than in the amount, even with the view of merely strengthening the remedy for the enforcement of a real contract such as *mutuum*,<sup>97</sup> by an additional promise simultaneously given at the time the loan is extended. In the case of the *constitutum debiti alieni*, which is the one that falls under the present discussion, as discussed further below, an obvious modification in the terms of the original debt is the debtor substitution or addition.

Various alternative theories have developed as to the origins of the *constitutum debiti alieni*,<sup>98</sup> in any event, it is speculated that its introduction to Roman law came to fill a gap between liability of a surety and that under an indemnity, or in the contemporary terminology, between *fidejussio* and *mandatum pecuniae credendae*. The *fidejussio* is a formal guarantee, given by way of a stipulation, discussed further below in section 6, under which **Paymaster**, as a surety,

<sup>93</sup> The promise was given through a *sponsio dimidae partis*; for this procedure see Berger above n 2 at 713. The liability of the unsuccessful plaintiff for the penalty on his own counter-promise is further explained by Thomas, *Institutes* above n 39 at 328 (Commentary on Justinian's *Institutes* Book IV, Title XVI).

<sup>94</sup> Thomas, *ibid* at 248 is definite about this point.

<sup>95</sup> A point highlighted by Platon, above n 88 at 193 who compares it to the acceptor's engagement on a bill of exchange under modern law (whose origins are discussed in ch 8 below).

<sup>96</sup> A point highlighted by Platon, *ibid* at 191, who calls such a mode of communication by letter *l'epistola*, and notes the similarity of the letter to the subsequent bill of exchange, (whose origins are discussed in ch 8 below). According to Berger, above n 2 at 454, *Espitula* is a private letter that becomes the property of the addressee upon receipt; 'Certain agreements, primarily consensual contracts . . . might be concluded by letter (*per epistulam*).'

<sup>97</sup> For classification of contracts see concluding paragraphs in section 1 above.

<sup>98</sup> For a detailed discussion of four theories see eg Coulon, above n 92 at 6–23. One such theory traces the origins into Oriental legal systems with which the Romans came into contact upon conquering and expanding their Empire to include the East Mediterranean. On this, see more in E Revillout, *Les Obligations en Droit Égyptien* (Paris: Ernest Leroux, 1886) who traces (at 179–84) these origins in the context of the Egyptian law of guarantee. Cf Platon, above n 88, who discusses at 165–77 whether the *constitut* originated from the Greek and Egyptian '*hémionion*' (or penalty obligation attached to a delayed payment of a debt to which the creditor agreed).



undertakes to pay **Creditor**, an existing debt of the principal debtor **Debtor**.<sup>99</sup> It is a verbal, formal *stricti juris* unilateral contract. The *mandatum pecuniae credendae* is an order to extend credit to a third person; it creates an undertaking by the order giver, the would-be **Paymaster**, to indemnify the order-receiver, the would-be **Creditor**, for losses the latter may incur should he extend credit to the third person, the would-be **Debtor**, on the basis of this order.<sup>100</sup> Effectively, it is an undertaking by **Paymaster** to indemnify **Creditor**, should the principal debtor, **Debtor**, default on the repayment of the credit extended to him by **Creditor**.

The *mandatum pecuniae credendae* is a consensual bilateral *bonae fidei* informal contract.<sup>101</sup> Like the *mandatum pecuniae credendae*, and in contrast to the *fidejussio*, the *constitutum debiti alieni* has the benefit of informality and does not require **Paymaster**'s promise to be given in **Creditor**'s presence; in principle, it also preserves for **Creditor** the power to pursue both **Debtor** and **Paymaster**.<sup>102</sup> At the same time, like the *fidejussio*, and in contrast to the *mandatum pecuniae credendae*, the *constitutum debiti alieni* is not limited to a future obligation to occur after **Paymaster**'s undertaking to **Creditor** and is in an ascertained amount rather than for unascertained losses.<sup>103</sup>

Like the banker's promise on *receptum argentarii*, the *constitutum* promise does not lead to the novation of the pre-existing debt, and does not supersede it; it gives the creditor the option of an alternative remedy. Contrary to the stipulation discussed further below in section 6, the *constitutum* promise is given on the initiative of the party to become liable on it, and not in response to a creditor's question; as such, and contrary to the *receptum argentarii*, the *constitutum* promise is not presumed to be autonomous and free of defences arising from the pre-existing debt, including as to its validity. However, both the lack of a novatory effect and autonomy may have been based on the intention of the parties, and hence are more certain to exist in *constitutum proprii* than in *constitutum debiti alieni*; the latter may nevertheless be taken to be intended both to discharge the original debtor, so as to have a novatory effect, and to be autonomous in relation to the original debtor's pre-existing debt (that is, the one owed by **Debtor** to **Creditor**).<sup>104</sup> However, in the absence of novation, it is not all that obvious what legal doctrine could implement such intent.

Possibly with this uncertainty in mind, Maxwell does not draw any distinction between the two types of *constitutum*; in a context that ought to be taken

<sup>99</sup> See in general, Berger, above n 2 at 350 (v. 'Adpromissio').

<sup>100</sup> See in general, Berger, *ibid* at 575.

<sup>101</sup> For classification of contracts see concluding paragraphs in section 1 above.

<sup>102</sup> But *cf* text and n 104 below.

<sup>103</sup> See Coulon, above n 92, particularly at 39–41, and 102–11.

<sup>104</sup> On this point see particularly Philippin, above n 92 at 88–93, where the Praetorian basis of the *constitutum* (see text and n 87 above) is cited as the justification for reliance on the parties' intention. For the role of the intention of the parties see also E Bodin, 'Des Effets du Pacte de Constitut' (1866) 12 *Revue Historique de Droit Français et Étranger* 209. For a detailed analysis as to whether particularly the *constitutum debiti alieni* is to be taken as substituting the debtor, adding a co-debtor, or giving rise to a guarantee see Déjardin, above n 92 at 67–98.

to refer to the *constitutum debiti alieni*, he speaks of the continued existence of the original debt owed by **Debtor** to **Creditor**, so as to render the delegation of it to **Paymaster** by means of *constitutum* as ‘imperfect’.<sup>105</sup> It may however be plausibly argued that, having agreed to accept **Paymaster** as a substitute debtor, **Creditor** may be precluded from suing **Debtor**; namely, **Debtor** may successfully defend **Creditor**’s action on the basis of **Creditor**’s agreement to substitute **Debtor**’s obligation by that of **Paymaster**.<sup>106</sup> From this perspective, while **Debtor**’s obligation has not become extinct, as under novation, it may nevertheless not be resorted to by **Creditor**. It may also be argued that in undertaking to pay **Debtor**’s debt to **Creditor**, **Paymaster** may have been taken to agree to pay the sum owed, irrespective of the obligation that gave rise to it, and hence **Paymaster** is not able to raise defences available on **Creditor**’s action to enforce **Debtor**’s original obligation.<sup>107</sup> In effect, this renders **Paymaster**’s undertaking autonomous.

Under both the *receptum* and *constitutum*, in undertaking towards **Creditor**, **Paymaster** appears to act as a mandatary for **Debtor**, seeking either the release of **Debtor** towards **Creditor**, or to make **Debtor** entitled to claim from **Creditor** under the transaction for which payment is made. Upon payment to **Creditor**, **Debtor** is discharged towards **Creditor** and **Paymaster** becomes entitled to reimbursement from **Debtor**.<sup>108</sup>

## 6. PERFECT EXECUTION OF THE DELEGATION: NOVATION BY STIPULATION

### 6.1 Enforceability by Creditor of Paymaster’s Undertaking

A most frequently used route for a perfect execution of the delegation is *stipulatio*, or in English, stipulation.<sup>109</sup> The *stipulatio* is an oral solemn contract concluded in the form of a face-to-face exchange of a question and answer between two persons who, on the basis of the successful completion of the exchange, become parties to a contract. It is a formal, verbal, unilateral, and *stricti juris* contract;<sup>110</sup> its formation requires a question to be asked by the stipulant, a

<sup>105</sup> Maxwell, above n 2 at 66. For the non-novatory/non-discharging effect of *constitutum debiti alieni* see also E. Gaudemet, *Étude sur le Transport de Dettes* (Paris: Arthur Rousseau, 1898) at 146–52.

<sup>106</sup> Coulon, above n 92 at 74–84. Indeed, in defending against **Creditor**’s action, **Debtor** relies on **Creditor**’s agreement expressed in **Creditor**–**Paymaster** contract, to which **Debtor** is not a party; nevertheless, **Debtor** effectively invokes against **Creditor** an ‘*exceptio doli*’ – a defence based on **Creditor**’s alleged fraud. In connection with the defence of fraud, privity was not always rigorously applied, and hence, under such circumstances, this defence is to be made available to **Debtor**. *Ibid* at 79–80. For ‘*exceptio doli*’ in general, see Berger above n 2 at 459.

<sup>107</sup> Coulon, *ibid* at 84–95.

<sup>108</sup> Platon, above n 88 at 52–53. See also Coulon, *ibid* at 95–99.

<sup>109</sup> See definition in Berger, above n 2 at 716 and analysis in eg Lee, above n 6 at 298–304 and Nicholas, above n 5 at 193–96.

<sup>110</sup> For classification of contracts see concluding paragraphs in section 1 above.



would-be promisee-creditor, immediately followed by an affirmative answer given by the person to whom the question was directed, who thereby becomes the promisor-debtor. The two parties must be in each others' presence and the question and answer must be spoken; furthermore, 'there should be precise correspondence between question and answer.'<sup>111</sup> A stipulation could encompass any type of obligation; where it is to pay a sum certain in money is a *stipulatio certa*.<sup>112</sup>

In our setting, as for example where **Paymaster** owes **Debtor** who owes **Creditor**, at the 'bidding' of **Debtor**, **Creditor** stipulates from **Paymaster** for the money owed; that is, **Creditor** asks **Paymaster** if he will pay **Creditor**, and **Paymaster** answers affirmatively. Acceptance by **Paymaster** of **Debtor's** order is thus by means of communication by **Paymaster** to **Creditor**, the beneficiary of **Debtor's** order, in response to **Creditor's** question addressed to **Paymaster**, rather than by means of a communication from **Paymaster** to **Debtor**, who gave the order. It is in this sense that **Paymaster's** acceptance of the delegation towards **Creditor** is beyond **Paymaster's** acceptance of **Debtor's** mandate; in fact, the acceptance of **Debtor's** mandate other than by means of **Paymaster's** stipulatory obligation towards **Creditor** is thereby rendered irrelevant.<sup>113</sup>

Where **Paymaster's** acceptance is by agreeing to pay, the delegation thus consists of an order by **Debtor** to **Paymaster**, and a stipulation by **Creditor** from **Paymaster**. For his part, **Creditor** is not concerned with **Debtor's** order, but rather with **Paymaster's** binding undertaking to perform **Debtor's** obligation; in theory, **Paymaster's** undertaking may even be given to **Creditor** regardless of any order given to **Paymaster** by **Debtor**. To that end, the importance of the delegation order is merely to trigger the stipulatory obligation to be incurred by **Paymaster**, on whose basis **Paymaster** becomes bound to **Creditor**. In practice however, **Creditor** will not approach **Paymaster** for the stipulation, unless advised in advance of the possibility that **Paymaster** may agree to perform **Debtor's** obligation, usually on the basis of the order given by **Debtor** to **Paymaster**. Thus, somewhere between the order and the stipulation, or in any event, prior to the stipulation, **Creditor** is to be advised of the order or of **Paymaster's** possible readiness to undertake **Creditor's** obligation. Such advice may be given to **Creditor** by either **Debtor** or **Paymaster**.

All three parties, namely **Debtor**, **Paymaster**, and **Creditor**, may be present in one place, so that the stipulation could immediately follow the giving of the order. However, there is no requirement for the presence of all three in one location or for the operation to take place instantaneously in an uninterrupted

<sup>111</sup> Lee, above n 6 at 298. See also Nicholas, above n 5 at 193. Berger above n 2 states at 716, v. '*Stipulatio*', that '[t]he answer had to agree perfectly with the question; any difference or restriction (addition of a condition) made the stipulatio void.' But see Lee *ibid* at 416, Roby, above n 2 at 39, and Maxwell, above n 2 at 57 as to the effect of a condition added to the stipulatory answer.

<sup>112</sup> Defined by Berger, *ibid* at 717 as a 'stipulation in which the thing promised . . . its quality . . . and quantity were precisely fixed.' It is thus to be contrasted with *stipulatio incerta*. *Ibid*.

<sup>113</sup> Cf Lee, above n 6 at 334 speaking of '[t]he binding character of the mandate [as] . . . based . . . upon the detriment to the [mandatary] in changing his position at the mandator's instance.'

sequence. What is effectively required is the occurrence of all three stages, each at its own time and place, though practically, in the following sequence:

- (i) A one-way communication from **Debtor** to **Paymaster** (the order);
- (ii) Another one-way communication to **Creditor**, either directly from **Debtor** or from **Paymaster**, advising **Creditor** of the order or otherwise of the possibility that **Paymaster** may agree to perform **Debtor's** obligation to **Creditor**; and
- (iii) An exchange of communications between **Creditor** and **Paymaster**, consisting of a question by **Creditor** and an answer by **Paymaster**, which constitutes the stipulation.

As indicated, the second communication is a matter of practicality; it is not essential from a doctrinal perspective. Among the three stages, the stipulation, forming the third stage, is the only formality to be met; no requirements as to form exist as to the first stage, that of the order. As should be obvious, neither are there any requirements as to form with regard to the second stage; that of the communication to **Creditor**.

In an auction, a banker usually acted as an intermediary.<sup>114</sup> The stipulation was the mechanism through which he ordered payment of his own commission from the owner of goods (or other items) to be auctioned. Stipulation was also the mechanism through which the banker, in response to the owner's aforesaid stipulatory obligation, committed himself to pay the owner the purchase price offered by the highest bidder.<sup>115</sup> A banker's stipulatory obligation for the highest bid could be given either after such a bid was entered or for any future bid in a given auction. In turn, the banker either paid out of funds placed with him by the buyer in advance, or stipulated from the buyer for the payment made (or to be made) to the owner. There is however a controversy as to the role the banker played. He could have acted in an auction (i) as the vendor,<sup>116</sup> effectively<sup>117</sup> as a representative of the owner acting as the legal vendor,<sup>118</sup> (ii) as an independent intermediary, or (iii) as

<sup>114</sup> For the banker's role in auctions see ch 3, section 4, text at nn 111–17 above. Sources are cited in this section in nn 118 and 120 below.

<sup>115</sup> Platon, above n 88 at 21–43 particularly at 28–31. In practice, the banker's obligation and actual payment to the owner were in the sum of the highest bid less the commission. The mechanism of *stipulatio* was also employed for the collection of an auction tax deducted from the amount paid to the owner. See M García Morcillo, 'Auctions, Bankers and Public Finances in the Roman World' in K Verboven, K Vanderpe and V Chankowski (eds), *Pistoi Dia Tèn Technèn-Bankers, Loans and Archives in the Ancient World: Studies in Honour of Raymond Bogaert* (Leuven: Peeters, 2008) at 257, 258 (hereafter: Verboven et al, *Ancient World*).

<sup>116</sup> In support of this view see eg F Sturm, 'Stipulation Argentaria' in FBJ Wubbe and JA Ankum, *Mélanges Felix Wubbe: Offerts par ses Collègues et ses Amis à l'Occasion de son Soixante-dixième Anniversaire* (Fribourg: Éditions Universitaire, 1993) at 453, 460–63.

<sup>117</sup> Notwithstanding, and as an exception to, general adherence by Roman law to strict privity requirements and resistance to any theory of conferring rights on a non-party to a contract pointed above out above in n 59 and text around it.

<sup>118</sup> For preferring the latter over the former, see H Ankum, 'Quelques Problèmes concernant les Ventes aux Enchères en Droit Romain Classique', in G Scherillo (ed), *Studi in onore di Gaetano Scherillo* (Milan: Cisalpino-La goliardica, 1972) vol I at 377.

a paymaster instructed by the buyer<sup>119</sup> to discharge the buyer's debt to the owner acting as the legal vendor.<sup>120</sup> In each of the first two cases, the buyer's stipulatory obligation to the banker<sup>121</sup> was to pay the purchase price; in the latter, it was to repay a loan whose proceeds were used to purchase the goods.<sup>122</sup>

## 6.2 Scope and Impact of Paymaster's Undertaking

As indicated, other than dealing with the first issue, that of the requirements as to the binding effect of **Paymaster's** promise and its enforceability by **Creditor**, the analysis of the legal nature of **Paymaster's** acceptance or agreement to execute **Debtor's** order revolves around a second principal issue. This second issue is the scope of **Paymaster's** undertaking under his promise to **Creditor**, and its relationship with the original obligations by **Debtor** to **Creditor** as well as by **Paymaster** and **Debtor**.<sup>123</sup>

On this point, the effect of **Paymaster's** stipulatory obligation to **Creditor** has been to replace an original obligation and not to co-exist side by side with it.<sup>124</sup> Stated otherwise, **Paymaster** has been seen as incurring liability to **Creditor**, neither as a surety for, nor as a co-debtor with, **Debtor**. Rather, the underpinning legal theory of the stipulation is that of *novatio* or novation,<sup>125</sup> namely the

<sup>119</sup> Certainly, the buyer's instruction could be implicit, by either having deposited funds with the banker, or incurring a stipulatory obligation to him. For the informality of the delegation order, see text at n 4 above.

<sup>120</sup> The latter is the preferred view of JAC Thomas, 'The Auction Sale in Roman Law' (1957), *Juridical Review* 42 (hereafter: Thomas, 'Auction'), as well as of A Petrucci, 'Riesame del Ruolo dei Banchieri nelle *Aucliones* Private nel Diritto Classico Romano' in Verboven et al, *Ancient World*, above n 115 at 277 [in Italian] of which I had the benefit of a partial unofficial English translation. Petrucci further argues that in running the auction for the owner the banker was acting under a contract for work (*locatio conductio operis*). The nature of this type of contract is set out at the beginning of section 3 above.

<sup>121</sup> Thomas, *ibid* at 63–64 discusses the case in which the successful bidder refused to promise the price to the banker.

<sup>122</sup> For the 'so called *mutuum cum stipulatione*' as a form under which an informal loan contract (*mutuum*) is supplemented by a *stipulatio* in which the borrower promises the repayment of the loan, and the suggestion that this 'combined model' creates a *contractus re et verbis* which is to be regarded as a category of classical Roman law, see P Gröschler, 'Die Konzeption Des *Mutuum cum Stipulatione*' (2006), 74 *Legal History Review* 261 at 286–87 (English summary). For classes of contract see concluding paragraphs in section 1 above. Loan documents following this form may not record interest stipulations; this does not necessarily mean that no interest was charged. See K Verboven, 'The Sulpicii from Puteoli and Usury in the Early Roman Empire' (2003), 71 *Legal History Review* 7. For the *stipulatio* as an obligation to repay interest on a loan see above nn 27–28 and text.

<sup>123</sup> For a particularly comprehensive and useful discussion see Maxwell, above n 2 at 55–57 and 67–105, particularly at 88–105.

<sup>124</sup> To that end, in an auction, regardless of the legal characterization of the banker's role as discussed above in the last paragraph of section 6.1, it is agreed that the owner who stipulated from a banker bears the risk of the banker's insolvency, in which case he has no recourse from the buyer. See Digest 5.3.18, reproduced in Mommsen et al, above n 30, vol I at 186. See eg discussion by Ankum, above n 118 at 387 and Thomas, 'Auction', above n 120 at 53–54.

<sup>125</sup> For this 'chain reaction' of required stipulation leading to novation, see Gaius' Institutes §38, Gordon and Robinson, above n 59 at 139–41.

process of transformation and transfer of a former obligation into a new one, under which an existing obligation is extinguished and substituted by a new one.<sup>126</sup>

It ought to be conceded, however, that grounds for the application of novation have not been all that solid. Indeed, it could well be that, originally, novation was premised on a theory which precluded the existence of successive distinct obligations in relation to the same debt. Under this theory, with respect to any debt, the automatic effect of an obligation subsequently incurred must have been to supersede altogether the one incurred earlier, and not to co-exist with it in any way.<sup>127</sup> To that end, it was only Justinian's law which '[a]ccording to a widespread opinion . . . set the requirement that a *novatio* was valid only when the parties had the intention to make *novatio* (*animus novandi*).<sup>128</sup> Nevertheless, it is conceded that 'it is hardly conceivable that in the developed classical law . . . the intention of the parties must have been completely neglected.'<sup>128</sup> According to such a view, already ahead of Justinian, it was the presumed intention of the parties that must have been taken to play some role in the formation of the basis for the novatory effect of **Paymaster's** obligation to **Creditor**.<sup>129</sup> In principle, this would not have precluded the existence of cases involving a non-novatory **Paymaster's** stipulatory obligation that did not discharge **Debtor's** debt to **Creditor**.<sup>130</sup> At the same time, however, under what appears to be the contrary view, prior to Justinian, the effect of **Paymaster's** stipulatory obligation to **Creditor** must have been taken automatically, as a matter of law, to discharge **Debtor's** debt to **Creditor**, where the latter existed.<sup>131</sup>

Arguably, however, the latter view must be taken to apply only in the absence of any indication to the contrary, in either the language of the stipulation, or possibly in the language of another contract between the parties. In the final analysis, these two apparently conflicting views are not irreconcilable. Possibly then, until Justinian, the automatic effect of a stipulation (by **Paymaster**) with

<sup>126</sup> *Novatio* is defined in Berger, above n 2 at 600 and discussed in the context of delegation and stipulation eg in Roby, above n 2 at 38–41; Dannenbring, above n 2 at 267–69; and Hunter, above n 2 at 629–32.

<sup>127</sup> This 'dominant doctrine' is indicated (and critically examined in the course of his discussion) eg in P Meylan, 'La réforme Justinienne de la novation: son sens et sa portée (C. VIII, 41.8)', *Acta Congressus Juridici Internationalis* (Rome: Pontificum Institutum Utriusque Iuris, 1935) vol I, 277 at 280, 304.

<sup>128</sup> Berger, above n 2 at 600. The classical period of Roman jurisprudence is taken to extend from the beginning of the Empire, as of around 27 BCE, to the middle of the third century CE. See n 5 above. As discussed further below, in section 8, particularly in the text around n 201, novation was substantially reformed in the sixth century CE by Justinian who made its existence (and hence the discharge of the pre-existing obligation) explicitly dependent on the clear expression of intent of the parties rather than the automatic operation of the stipulation. See Lee, above n 6 at 418.

<sup>129</sup> See eg Dannenbring, above n 2 at 268 and Roby, above n 2 at 39, who both refer to the *animus novandi*, ie, the intention to replace an old obligation for a new one.

<sup>130</sup> Badareu 'Tomsa', above n 3 at 50 names the 'non-novatory' delegation involved as 'imperfect' and points out that in French law of his time it has become the rule and not the exception. 'Imperfect' delegation in the sense used by Badareu 'Tomsa' is in any event to be distinguished from the imperfect execution of delegation discussed in section 5 above.

<sup>131</sup> See eg Maxwell, above n 2 at 37–47.

respect to an existing obligation (of **Debtor**) was presumed to discharge it, namely to generate novation.<sup>132</sup> As will be seen below, Justinian changed the requirements for forming a stipulation. He was not satisfied with the presumed intention of the parties and insisted on the demonstration of express intention. From this perspective, Justinian did not introduce a new requirement as to intention; rather, he reversed the presumption as to the existence of intention.

In any event, even accepting the novatory effect of **Paymaster's** obligation to **Creditor**, the execution of the delegation by him may be in the context of two obligations, that of **Debtor** to **Creditor** and that of **Paymaster** to **Debtor**. Both the scope of **Paymaster's** obligation to **Creditor** and its overall impact depend on the type of delegation involved. To that end, a distinction lies first between a qualified and absolute (or pure) delegation. The distinction hinges on whether **Paymaster's** stipulatory obligation purports to incorporate a pre-existing obligation or debt or whether it is merely in the sum owed under such a pre-existing debt or obligation. In the former case the delegation is qualified; in the latter it is absolute (or pure).<sup>133</sup>

As well, for a qualified delegation, two possibilities or cases exist. First, **Paymaster** may undertake to pay **Creditor** the debt owed to **Creditor** by **Debtor**. Alternatively, **Paymaster** may undertake to pay **Creditor** the debt owed by **Paymaster** to **Debtor**.<sup>134</sup> Either way, the execution of a qualified delegation involves a transfer (*cessio* or cession) of a pre-existing obligation.<sup>135</sup>

The first case of a qualified delegation is executed by **Paymaster's** undertaking to pay **Creditor** the debt owed by **Debtor** to **Creditor**. It involves novation by means of a change in the debtor owing on **Debtor's** obligation to **Creditor**; in this case, the transfer of a debt or passive obligation takes place, so that **Paymaster** becomes liable to **Creditor** on **Debtor's** original obligation, and hence, only to the extent that **Debtor** would have owed **Creditor**. To that end, **Paymaster** may invoke

<sup>132</sup> Thomas, *Institutes* above n 39 at 257 (Commentary on Justinian's Institutes Book III, Title XXIX).

<sup>133</sup> The distinction is that of Maxwell, above n 2 at 55–57 and 88–95 (particularly 90–92). See also Badareu 'Tomsa', above n 3 at 39–41 distinguishing (even in the absence of novation) between 'certain' and 'uncertain' stipulation, effectively corresponding respectively, to absolute and qualified delegation, and pointing out that the 'certain' (ie 'absolute') type has been the more common. In contrast, see eg Roby, above n 2 at 45–47 who neither points out the distinction nor uses the term 'qualified delegation' (or any similar term) but rather deals with what Maxwell calls a qualified delegation as the only mode for the performance of the delegation.

<sup>134</sup> According to Roby and Buckler, who both exclusively treat what Maxwell calls a qualified delegation as an ordinary delegation (*ibid*), the former case is that of *expromissio*, while only the latter is strictly speaking a case of *delegatio*. See Roby, *ibid* at 45–46; and WH Buckler, *The Origin and History of Contract in Roman Law* (London: CJ Clay and Sons, 1895) at 110. See also Badareu 'Tomsa', above n 3 at 40 speaking (even in the absence of novation) only on the latter as a case of 'uncertain' stipulation (hence of a 'qualified' delegation; see n 133 above). However, according to Berger, above n 2 at 465 (v. *expromittere*), *expromissio* covers **Paymaster's** obligation in both cases.

<sup>135</sup> For *cessio* see Berger, above n 2 at 387. For a comprehensive discussion on the transfer of debts by delegation see Gaudemet, above n 105 at 49–53. Apart from delegation, *cessio* is further discussed in section 9 below.

against **Creditor** any defence that would have been available to **Debtor**,<sup>136</sup> and **Creditor** remains entitled to the benefit of all securities given by **Debtor**.<sup>137</sup>

The second case of a qualified delegation is executed by **Paymaster's** undertaking to pay **Creditor** the debt owed by **Paymaster** to **Debtor**. It involves novation by means of a change in the creditor to whom **Paymaster** owes; in this case the transfer of a credit or active obligation takes place. In such a case, **Paymaster** remains liable on his own original obligation, though to a new creditor; **Paymaster** may thus raise against **Creditor** any defence that would have been available to **Paymaster** against **Debtor**, and **Creditor** becomes entitled to **Paymaster's** securities given to **Debtor**.<sup>138</sup>

In any event, inasmuch as it involves the transfer of either the passive or active obligation, respectively from **Debtor** to **Paymaster** and from **Debtor** to **Creditor**, it is the qualified delegation in connection with which 'a rudimentary assignability of obligations by virtue of *delegatio*' is said to be created.<sup>139</sup>

In contrast to the qualified delegation, the absolute (or pure) delegation does not involve any transfer of an obligation, whether passive or active.<sup>140</sup> Rather, the

<sup>136</sup> A buyer in an auction is released towards the banker on the basis of either (i) non-delivery of the goods to the buyer (*The Institutes of Gaius*, Book IV §126a. See eg Gordon and Robinson, above n 59 at 495); or (ii) the rescission of the contract for sale due to hidden defects in the goods (Digest 44.4.5.4, reproduced in Mommsen et al, above n 30, vol IV at 635), in which case the banker is released towards the owner. Both sources are consistent either with the transfer of a passive obligation, as in the accompanying text, or with the buyer's obligation to the banker being that of a buyer to the seller. Note however, that a different take by Petrucci, above n 120, according to whom the mere mention of these cases in the sources indicates that their underlying rule provides for a specific exception, designed to protect the buyer in an auction, who would otherwise be absolutely liable to the banker, whose own obligation to the owner (consistently with the buyer's absolute (or pure) delegation to him), would have been otherwise absolute and unconditional. For other explanations (one of which is set out below in n 143, see Thomas, 'Auction', above n 120 at 45–60. For the characterization of the banker running an auction see above, in last paragraph in section 6.1. Both sources are discussed by Ankum, above n 118 at 388–93.

<sup>137</sup> For this first case, that of **Paymaster's** undertaking to pay **Creditor** the debt owed by **Debtor** to **Creditor**, see eg Hunter, above n 2 at 631.

<sup>138</sup> For both cases of a qualified delegation, see particularly Maxwell, above n 2 at 55–57 and 89–92, as well as at 48–51. Note though Roby's distinction, above n 2 at 46, applicable to both transfers of debt and credit, between defences under the transferred obligations, that pass, and personal defences of the original debtor, that do not pass. But see A Demangeat, *Droit Romain: De la Cession de Créances. Droit des Gens: De la Jurisdiction en Matière de Prises Maritimes* (Paris: A Giard, Libraire-Éditeur, 1890) (hereafter: Demangeat, *Droit Romain*) who effectively treats the transfer of credit (without using the term) as the only mode for the performance of a delegation and who argues (at 13–16) that in the process **Paymaster's** securities given to **Debtor** as well as defences available against **Creditor** and which are unknown to him are forfeited, and that other defences are available to him against **Creditor** only either in a separate action or by way of defence to **Creditor** where **Creditor** would have gained by their extinction.

<sup>139</sup> Buckler, above n 134 at 110. Also Roby above n 2 at 45–47. It is to that end that it is said that novation in Roman law was premised on the transfer of debts: R Saleilles, 'De la Cession de Dettes' (1890) 4 *Annales de Droit Commercial et Industriel Français, Étranger et International* 1 at 1. But see discussion on absolute delegation in the paragraph that immediately follows.

<sup>140</sup> But see Lanata, above n 2 at 13–14 who effectively treats (what is under Maxwell) the absolute delegation as a means for the transfer of debts (though free of defences attached to the transferred obligation).



absolute delegation involves the transformation of both original obligations, that of **Creditor** to **Debtor** and that of **Paymaster** to **Debtor**, into a new one. Under an absolute (pure) delegation, **Paymaster's** stipulatory obligation is to pay **Creditor** a specific sum of money that happens to be in the same amount of the debt owed by **Paymaster** to **Debtor** and by **Debtor** to **Creditor**. **Paymaster's** stipulatory obligation may be identified by reference to either debt, though as purely an abstract obligation in the relevant amount. The effect of the novation is thus to extinguish **Debtor's** original obligation towards **Creditor**, and replace it with **Paymaster's** new obligation to **Creditor**.

Derived from a verbal and formal contract, and not purporting to incorporate any pre-existing obligation, **Paymaster's** new obligation to **Creditor** is *stricti juris* and hence unilateral; that is, it is abstract and self-contained, namely, confined to the contours of the formula and not subject to any outside event.<sup>141</sup> Both original obligations, that of **Debtor** to **Creditor** and of **Paymaster** to **Debtor**, are transformed into a novated obligation owed by **Paymaster** to **Creditor**. Contrary to the qualified delegation scenario, neither is transferred into **Paymaster's** new obligation to **Creditor**. In the process of creating **Paymaster's** novated obligation, both defences and securities available under and for the original obligations, that of **Paymaster** to **Debtor** and that of **Debtor** to **Creditor**, have been forfeited. **Paymaster** may invoke against **Creditor** only defences based either on the nullity of the novated obligation or on public policy grounds.<sup>142</sup>

A delegation order may however be given to **Paymaster** by **Debtor** under the reservation of risk. In such a case, whether the delegation executed in compliance with **Debtor's** order is absolute or qualified, **Debtor** is not discharged altogether, and remains liable to **Creditor** as a guarantor of **Paymaster's** stipulatory obligation towards **Creditor**.<sup>143</sup> However, the reservation of risk is to be expressly stated and is not usual; otherwise, the delegation is deemed to be without the reservation of risk. In the usual case, namely, that of the execution of a delegation order given without the reservation of risk, **Debtor's** discharge towards **Creditor** by means of **Paymaster's** stipulatory obligation is premised on the power to discharge a debt of another; 'For, just as I can discharge your debt by payment without your

<sup>141</sup> But see D Daube, 'Novation of Obligations Giving a Bonae Fidei Iudicium' (1948) 66 *Zeitschrift der Savigny-Stiftung für Rechtsgeschichte* 91, who argues that a stipulatory obligation of a promisor to perform an obligation he incurred under a *bona fide* contract does not create a *stricti juris* obligation; rather, the stipulatory obligation is of the same nature as the one it replaces. For classification of contracts see concluding paragraphs in section 1 above. It appears that if, as thought by Thomas, 'Auction', above n 120 at 47, the same view applies to the effect of a stipulatory obligation by one person (**Paymaster**) to carry out an obligation of another (**Debtor**), absolute (or pure) delegation becomes impossible; this is so since the theory of an absolute (or pure) delegation is premised on breaking up the connection, or disassociating between the original contract of **Debtor** and the substituting undertaking of **Paymaster**.

<sup>142</sup> For a detailed discussion, see Maxwell, above n 2 at 95–105.

<sup>143</sup> See eg Maxwell, above n 2 at 79–80. *Quaere* as to whether this is different in essence from the 'uncertain' stipulation of the 'imperfect' delegation of Badareu 'Tomsa', discussed in nn 131 and 133 above.

knowledge or consent, so I can discharge it by substituting agreement without your knowledge or consent.<sup>144</sup>

Based on the intention of the parties it is said that **Paymaster's** stipulatory obligation to **Creditor** is deemed to be performance by **Paymaster** of his original obligation towards **Debtor** which is thereby discharged.<sup>145</sup> **Paymaster's** execution thus 'extinguishes the obligation of [**Paymaster**] to [**Debtor**] and establishes in place thereof a new obligation of [**Paymaster**] to [**Creditor**].'<sup>146</sup> **Paymaster's** discharge to **Debtor** is indeed quite logical; if **Paymaster** becomes obligated to **Creditor** and **Debtor** is released towards **Creditor**, it is only natural that **Paymaster** is discharged towards **Debtor**. **Debtor** is however not a party to the stipulatory obligation of **Paymaster** to **Creditor** and, as a matter of legal doctrine, it is thus not all that obvious how **Paymaster's** original obligation to **Debtor** is discharged in the process. Lee speaks of the novation leading to **Debtor's** discharge towards **Creditor** as consisting also of 'an agreement . . . between all three parties by which [**Paymaster**]'s liability to [**Debtor**] was discharged and replaced by [**Paymaster**]'s liability to [**Creditor**].'<sup>147</sup> Yet, there is no discussion of the mechanism achieving such an overall tri-partite agreement, and while **Paymaster's** discharge towards **Debtor** may be self-explanatory in a qualified delegation in which **Paymaster** becomes obligated to pay to **Creditor** his own debt to **Debtor**,<sup>148</sup> no such clarity exists otherwise.

One may have speculated that an additional stipulation is required between **Debtor** and either **Creditor** or **Paymaster** in order to give effect to an overall tri-partite agreement.<sup>149</sup> If an additional stipulation is required, the arrangement in fact consists of a series of bilateral binding agreements, that may, though need not necessarily, be reached simultaneously, in the presence of all three in one location. In practice however this speculation has not been made.

Two alternative explanations for **Paymaster's** discharge towards **Debtor** may be proposed. First, discharge of **Paymaster** towards **Debtor** may be a matter of 'compensation'; that is, upon releasing **Debtor** from his obligation to **Creditor**, **Paymaster** may be seen as obtaining his discharge, on his obligation to **Debtor**, by 'compensating' or offsetting his opposing cross-claim against **Debtor** for the

<sup>144</sup> Lee, above n 6 at 415 and see n 61 and text above. See detailed discussion by Maxwell, above n 2 at 74–79, who specifically rejects (at 80–81) the existence of a general implied warranty by **Debtor** as to the solvency of **Paymaster**. *Quaere* however as to whether in order to achieve **Debtor's** discharge, mention of his debt to **Creditor** ought not to be included in **Paymaster's** stipulatory obligation to **Creditor**, the latter obligation being abstract, and standing on its own.

<sup>145</sup> Maxwell, *ibid* at 69.

<sup>146</sup> Roby, above n 2 at 44.

<sup>147</sup> Lee, above n 6 at 410.

<sup>148</sup> See Roby, above n 2 who states at 45, that where all three meet, and '[a]t [the delegant **Debtor**]'s bidding, [the delegatee **Creditor**] stipulates from [the person delegated **Paymaster**] for the debt that [the delegated person **Paymaster**] owes to [the delegant **Debtor**] . . . [The person delegated **Paymaster**] promises it and is thereby freed from his debt to [the delegant **Debtor**].'

<sup>149</sup> Namely, **Debtor** may procure either **Creditor's** stipulatory obligation to give him (**Debtor**) discharge in return for **Paymaster's** new obligation (or even payment) to **Creditor**, or **Paymaster's** stipulatory obligation to pay (or even payment to) **Creditor** in return to a discharge (to **Paymaster**) from **Debtor**.



indemnification for expenses incurred in carrying out his obligations as a mandatary.<sup>150</sup> Second, particularly taking into account the undeveloped stage in the evolution of compensation in Roman law, discharge of **Paymaster** towards **Debtor** may be on the basis of authorized substituted performance, or *datio in solutum* of **Paymaster's** obligation to **Debtor**, in the form of a stipulatory obligation incurred by **Paymaster** to **Creditor** at the bidding of **Debtor**.<sup>151</sup>

## 7. PERFECT EXECUTION OF THE DELEGATION: NOVATION OTHER THAN BY STIPULATION

Besides stipulation, two other mechanisms for the execution of delegation by means of novation are to be mentioned. These are (i) *litis contestatio* and (ii) the debtor's acknowledgement of an entry posted to the creditor's *codex accepti et expensi*.<sup>152</sup>

### 7.1 *Litis Contestatio*

The first machinery is *litis contestatio*.<sup>153</sup> It is the final act in legal proceedings, by which, after the appointment of the judge, the controversial issues are established and submitted to the latter for the examination of facts and for judgment.<sup>154</sup> This is the act in which the issues are crystallized, and whose occurrence marks 'the moment of joinder of issue . . . , i.e. the moment by reference to which the issues between the parties must be decided and after which there can be no alteration of the pleadings and no fresh action on the same issue.'<sup>155</sup> By the fourth century CE, *litis contestatio* lost its effect with the gradual disintegration and final disappearance of the formulary procedure of which it was a

<sup>150</sup> And yet, in the absence of a binding agreement between **Debtor** and **Paymaster** (eg by stipulation), it is hard to see how **Paymaster's** right to indemnification arises as early as upon his stipulatory undertaking to pay **Creditor**, ie, prior to actual payment by **Paymaster** to **Creditor**. Note further that the alleged compensation is between **Debtor's** indemnification obligation to his mandatary **Paymaster** and **Paymaster's** pre-existing obligation to **Debtor** (which is to be discharged in the process); the latter may or may not be *stricti juris* and hence unilateral as well as possibly being or not being that of a banker.

<sup>151</sup> For the application of both theories to explain the discharge of the person delegated (**Paymaster**) to the delegator (**Debtor**), see text and nn 63–76 above.

<sup>152</sup> Other than stipulation and these two, Maxwell, above n 2 at 64–65 briefly discusses the *dotis dictio*, which is a unilateral verbal contract under which a dowry is established in favour of a future husband by his future wife, her male relative, or her debtor complying with her instruction; in the latter case it involves the discharge of the obligation to establish the dowry, and hence novation, through the execution of a delegation order. See also *ibid* at 81, Berger, above n 2 at 435 (v. '*Dictio dotis*') and Lee, above n 6 at 297–98. As a commercial matter this may not be significant and will not be discussed here.

<sup>153</sup> For as a machinery for the execution of a delegation, see Maxwell, *ibid* at 62–64 and Lanata, above n 2 at 40–55.

<sup>154</sup> Berger, above n 2 at 566.

<sup>155</sup> Nicholas, above n 5 at 25.

part;<sup>156</sup> while it was effective, *litis contestatio* could however be used to execute a delegation.

*Litis contestatio* could occur either with or without the consent of **Paymaster**. Consent by **Paymaster** is nevertheless essential for *litis contestatio* to constitute a perfect execution of a delegation order, since without **Paymaster**'s agreement there is no execution of a delegation,<sup>157</sup> and of course no novation.<sup>158</sup> As a method for the execution of a delegation *litis contestatio* works as follows.<sup>159</sup> **Debtor**, a debtor of **Creditor** and creditor of **Paymaster** in an equal amount,<sup>160</sup> appoints **Paymaster** to represent him in **Creditor**'s action against **Debtor**. By voluntarily assuming this role, **Paymaster** effectively takes upon himself to have the 'condemnation' to pay **Creditor**, issued against him, **Paymaster**, personally.<sup>161</sup> **Debtor**'s appointment of **Paymaster** is in effect a delegation order, which **Paymaster** is taken to accept by complying with it. Having been 'condemned' to pay **Creditor**, **Paymaster** becomes obligated to pay **Creditor**; **Paymaster** is also released towards **Debtor** since his becoming obligated to **Creditor** is a substituted mode of performance, *datio in solutum*, of his obligation to **Debtor**.<sup>162</sup>

This is a qualified delegation; thereunder, it is said, albeit not convincingly in my view, **Paymaster** becomes obligated to pay **Creditor** the debt owed by **Paymaster** to **Debtor**.<sup>163</sup> As such it involves novation by means of a change in the creditor to whom **Paymaster** owes; in this case the transfer (*cessio* or cession) of a credit or *active* obligation takes place. In such a case, **Paymaster** remains liable on his own original obligation, though to a new creditor; **Paymaster** may thus raise against **Creditor** any defence that would have been available to **Paymaster** against **Debtor**, and **Creditor** becomes entitled to **Paymaster**'s securities given to **Debtor**. The transfer of a credit or active obligation novates solely **Paymaster**'s

<sup>156</sup> See Berger, above n 2 at 566, v. *litis contestatio*. For *litis contestatio* as part of the formulary procedure see eg Lee, above n 6 at 438–40. For the demise of the formulary procedure in 342 CE see Lee *ibid* at 456. See also Berger, *ibid* at 434 v. Formula, and 394 v. *Cognitio extra ordinem*.

<sup>157</sup> The point is highlighted by both Maxwell, above n 2 at 63 and Lanata, above n 2 at 41–43.

<sup>158</sup> For the consent of the new debtor as an element of novation, and for novation as the basis for the perfect execution of delegation see section 6.2 above.

<sup>159</sup> A clear description is that of Lanata, above n 2 at 41. See also Maxwell, above n 2 at 63.

<sup>160</sup> The mechanism may however be used also for either effectuating a gift or creating a debt, as long as all parties co-operate as described in the text.

<sup>161</sup> See Gaius' Institutes Book IV §§83–84 (the appointment by a litigant of either a *cognitor* (namely representative), or a *procurator* (namely a mandatary) to substitute him in court) and §87 (representative or mandatary 'condemned' to pay debt claimed from his principal); Gordon and Robinson, above n 59 at 469–73. Unlike a *procurator*, a *cognitor* was appointed in court in the presence of the other litigant. *Ibid*.

<sup>162</sup> For this doctrine see in general text at n 76 above.

<sup>163</sup> See Maxwell, above n 2 at 63 and Lanata, above n 2 at 44, to both of whom I feel obliged to concede. My own independent analysis would have led me to conclude, however, that **Paymaster** becomes obligated to **Creditor** on **Debtor**'s obligation to **Creditor** (rather than on **Paymaster**'s obligation to **Debtor**) which is the subject-matter of **Creditor**'s claim; this would have been a transfer (*cessio* or cession) of a debit or *passive* obligation. But either way it is a qualified delegation, under which an existing obligation is transferred.

obligation to Debtor, so that it leaves Debtor's debt to Creditor subsisting until full payment by Paymaster to Creditor.<sup>164</sup>

Nevertheless, as will be seen further below in section 9, *litis contestatio* may work so as to bind Paymaster to pay Creditor even without the consent of Paymaster. Such is the case where Debtor duly appoints Creditor as his representative to pursue an action against Paymaster. In that case *litis contestatio* results in the transfer (*cessio* or cession) of a credit or *active* obligation, under which Paymaster becomes obligated to pay Creditor the debt owed by Paymaster to Debtor. Indeed, as a mode of execution of delegation, *litis contestatio* is triggered by the appointment by Debtor of Paymaster as Debtor's representative as a defendant in an action to be brought by Creditor. At the same time, in the process leading to a cession, *litis contestatio* is triggered by the appointment by Debtor of Creditor as Debtor's representative in suing Paymaster. Paymaster's consent is required in the former but not the latter case. Arguably then, the view that *litis contestatio* was not strictly a form of novation, as '[i]t did not derive from the agreement of the parties',<sup>165</sup> ought to be limited to its operation as a mode of cession; in such a case, Debtor appoints Creditor as his representative to pursue an action against Paymaster, so that *litis contestatio* is not premised then on the consent of Paymaster.

## 7.2 Acknowledgment of an Entry Posted to 'Codex Accepti et Expensi'

Besides stipulation and *litis contestatio*, another mechanism for the execution of the delegation by way of novation is the *contract litteris*, or literal or written contract. Such a contract creates obligations only on the basis of a special kind of writing.<sup>166</sup> In the pre-classic period,<sup>167</sup> it arose from the acknowledgement by the debtor of a book-keeping entry made by the creditor.<sup>168</sup> It thus consisted of

<sup>164</sup> For the distinctions between qualified and absolute delegations see section 6.2 above.

<sup>165</sup> Thomas, *Institutes* above n 39 at 257 (Commentary on Justinian's Institutes Book III, Title XXIX). See also Lee, above n 6 at 416.

<sup>166</sup> See in general, Lee, above n 6 at 304–06, Maxwell, above n 2 at 58–62, and Roby, above n 2 dealing with the subject first at 64–66, and then in great detail at 279–96 under *litterarum obligatio*, which is the same as in Berger, above n 2 at 566–77. See section 2, first paragraph above.

<sup>167</sup> Gaius who 'is our only trustworthy source of direct information' on the subject and who unfortunately 'treats it very shortly' (Roby, *ibid* at 64–65) is '[o]ne of the most renowned Roman jurists of the middle of the second century [CE] (born after Hadrian)'. Berger, *ibid* at 481. Indeed, his timing falls squarely within the classical era (ie, the classical period of Roman jurisprudence is taken to extend from the beginning of the Empire, as of around 27 BCE, to the middle of the third century CE. See above, n 5); nevertheless, '[t]he ancient forms of *litterarum obligatio* became obsolete already in classical times'. Berger, *ibid* at 567. But cf Platon, above n 88 at 114, who is more cautious (pointing at the Diocletian era, namely 285–304 CE, as a possible cutoff time at least for the cessation of the practice, at least for non-bankers), but is in agreement as to the disuse of this form of contract by Gaius' time. In any event, Justinian mentions the disappearance of the literal obligation in the sense discussed here in his Institutes, Book III, Title XXI, Thomas, *Institutes* above n 39 at 224 and Commentary at 226.

<sup>168</sup> See Gaius' Institutes Book III §§128–30, Gordon and Robinson above n 59 at 339. See also De Zulueta, Part II, above n 73 at 163–66.

the debtor's acknowledgement of 'an entry in a creditor's ledger (*codex accepti et expensi*) of a payment actually made, or supposed to be made to a debtor' (emphasis added).<sup>169</sup> Making such an entry is called *expensilatio*;<sup>170</sup> the entry itself was called *nomina transcriptia*;<sup>171</sup> and its acknowledgement by the debtor created a unilateral, *stricti juris* formal contract by him to pay the creditor the sum of money specified in the book entry.<sup>172</sup>

Unlike the stipulation, the literal contract was available only for a money-debt and possibly restricted to Roman citizens.<sup>173</sup> At the same time, the literal contract was a flexible mechanism as it did not require the presence of all involved in one place and could be contracted *inter absentes*.<sup>174</sup> To that end, it is not obvious whether **Debtor's** acknowledgement was required to be reflected by a corresponding entry in his own *codex*, a letter from him, or otherwise; 'perhaps, there was no single exclusive form'.<sup>175</sup> This mode of incurring liability became obsolete with the falling into disuse of the book-keeping system that underlay it, so that '[l]ong before Justinian the old literal contract was a thing of the past'.<sup>176</sup> Yet, the old literal contract is of great interest in the context of this study, as it was frequently used by the *argentarii* in carrying out payments for their customers.<sup>177</sup>

In one form, leading to an *a re in personam* (literally, 'from a thing to a person') transfer, the literal contract was designed to replace, or in fact elevate, a debtor's pre-existing debt on a *bonae fidei* contract, by or into, a *stricti juris* contract so as to give the creditor stronger remedies and effectively forfeit potential debtor's defences arising from the original contract. For example, 'a debt on account of purchase or hire or partnership was entered [on the books] as if it had been money paid out';<sup>178</sup> namely, the original debt has been discharged and replaced by a debt for money owed as if on a loan.

In another form, leading to an *a persona in personam* (namely, 'from one person to another') transfer, the literal contract allowed **Creditor** to have **Debtor** replaced by the debtor's debtor, **Paymaster**. In such a case, **Creditor** closed the account against **Debtor** and entered the amount against **Paymaster**; '[Debtor] having . . . delegated [Paymaster] to [Creditor]' or 'got [Paymaster] to promise

<sup>169</sup> Lee, above n 6 at 304. Roughly speaking, the *accepti* and *expensis* respectively correspond to incoming receipts and outgoing disbursement. See also definition in Berger, above n 2 at 391.

<sup>170</sup> See definition in Berger, *ibid* at 464.

<sup>171</sup> See definition in Berger, *ibid* at 596.

<sup>172</sup> For classification of contracts see concluding paragraphs in section 1 above.

<sup>173</sup> On the existence of this restriction, Lee, above n 6 at 305 is more confident than Roby, above n 2 at 66.

<sup>174</sup> However, this advantage cannot be overstated; compare with the similar position under stipulation, as discussed above in the last paragraph of section 6.1.

<sup>175</sup> Thomas, *Institutes* above n 39 at 226 (Commentary on Justinian's Institutes Book III, Title XXI). Further on this controversy, see below discussion in this section.

<sup>176</sup> Lee, above n 6 at 304. Justinian's literal contract is merely a proof of loan, and is an entirely different matter. *Ibid*.

<sup>177</sup> Maxwell, above n 2 at 62.

<sup>178</sup> Roby, above n 2 at 65.

to pay to [Creditor] and got [Creditor] to accept [Paymaster] as a debtor instead of [Debtor]'.<sup>179</sup>

In the case of a literal contract, 'there would have been little difficulty in discerning [the presumed] intention' of the parties to generate novation.<sup>180</sup> To that end, being abstract, the obligation derived from a literal contract stands on its own; it supersedes any prior agreement for whose replacement it is given, so that defences under and securities to any prior agreement are extinguished in the transformation through novation and substitution.<sup>181</sup>

A controversy exists with respect to the entries to be posted to the books in order to carry out the literal contract. With respect to delegation, namely the use of the literal contract to replace **Debtor** by **Paymaster** as a debtor of **Creditor**, under one view, it suffices for **Creditor** to record on his books that the sum owed to him by **Debtor** is to be treated as if owed by **Paymaster**, and for **Paymaster** to write on his own books that the sum he owes **Debtor** is to become owed by him to **Creditor**. Furthermore, arguably, what is required from **Paymaster** is an acknowledgement of the entry posted in **Creditor**'s book, which ought not necessarily to have been in the form of an entry to his own *codex*. Under another view, the operation is not all that simple; in fact two book entries have to be posted in the books of each participant. Under this view, altogether six entries, two in each set of books, are to be posted in participants' three set of books as follows:<sup>182</sup>

1. **Creditor** is to post in his books that **Debtor**'s debt to him is paid and then to enter **Paymaster**'s debt to him as if on a loan disbursed by **Creditor** to **Paymaster**;
2. **Debtor** is to post in his books both receipt of payment by **Paymaster** and discharge of his own debt to **Creditor**; and
3. **Paymaster** is to post in his books payment made by him to **Debtor** and receipt of loan from **Creditor**.

Obviously, all entries reflect fictional transactions. This is the case for payment by **Debtor** to **Creditor** (posted in both books of **Creditor** and **Debtor**), payment made by **Paymaster** to **Creditor** (posted in both books of **Debtor** and **Paymaster**) and the loan extended by **Creditor** to **Paymaster** (posted in the books of both **Creditor** and **Paymaster**), all of which has never happened. The end result is, however, that both debts owed by **Debtor** to **Creditor** and **Paymaster** to **Debtor** are discharged and replaced by a new debt owed by **Paymaster** to **Creditor**.

A second unsettled controversy exists as to whether in order to generate a literal contract, a special set of books was required, or whether the normal records of accounts could be adequate. Maxwell is of the opinion that in any

<sup>179</sup> *Ibid.*

<sup>180</sup> Thomas, *Institutes* above n 39 at 257 (Commentary on Justinian's Institutes Book III, Title XXIX).

<sup>181</sup> Compare discussion in section 6.2 above, particularly in concluding four paragraphs.

<sup>182</sup> For the two views on the book-keeping system, see Maxwell, above n 2 at 59–62.

event, the bankers and rich financiers maintained special sets of books;<sup>183</sup> at least so far as their books are concerned this becomes a moot point. Indeed, the literal contract was frequently used by the *argentarii*, namely bankers, for effectuating in their clients' names the transfer of funds, that is, non-cash payments, instructed by the clients to be made to their creditors.<sup>184</sup> Undoubtedly, in carrying out such payments, a banker acted as a **Paymaster**, debiting the account of the payer **Debtor** and crediting the account of the payee **Creditor**.<sup>185</sup>

Nevertheless, the importance of the literal contract in providing a legal basis for a payment mechanism operated through banks cannot be overstated. This is so even if the perfect execution of a delegation order by means of a literal contract requires an entry to be posted on **Paymaster's** books. Contrary to the legal fundamentals underlying the operation of today's bank account, the legal effect of the literal contract is premised on the entry in the creditor's books,<sup>186</sup> **Creditor** in our paradigm; it is not premised on the entry posted by the banker-debtor<sup>187</sup> acting in our paradigm as **Paymaster**. The acknowledgement by the banker-**Paymaster**, by means of a book-entry in his *codex* or otherwise, serves only to confirm the contract established by the entry posted to the books of the **Creditor**.

In fact, bankers operated under strict book-keeping requirements, and were obligated to record their monetary operations in account books, called *rationes*. A banker was required to make such books available for production in a trial involving a client, even where the banker was not a party to the litigation.<sup>188</sup> Also, it is in connection with entries posted to such books that a banker suing his debtor was required to offset an amount the banker owed the debtor.<sup>189</sup> However, an entry posted to this type of book did not constitute a literal contract; a debtor remained liable on the specific transaction with respect to which the entry was made.<sup>190</sup> This record to which entries were posted is to be distinguished from the *codex accepti et expensi*,<sup>191</sup> and may in fact be considered to be the forerunner of the ledger reflecting the bank account.

At the same time, the contribution to the legal thinking underlying the bank account, made by the legal theory underlying the literal contract created by posting the *nomina transcriptia* to the *codex accepti et expensi*,<sup>192</sup> cannot be

<sup>183</sup> Maxwell, above n 2 at 59.

<sup>184</sup> *Ibid* at 62.

<sup>185</sup> See section 4, second paragraph above, and section 10 below.

<sup>186</sup> See text and n 168 above.

<sup>187</sup> As acknowledged by Lanata, above n 2 at 46.

<sup>188</sup> See Berger, above n 2 at 366–67 (v. '*Argentarii*').

<sup>189</sup> See text at nn 70–73 above.

<sup>190</sup> For **Debtor's** discharge to **Creditor** and the liability of the banker (**Paymaster**) to **Creditor** upon posting entries to his (**Paymaster's**) records in compliance with **Debtor's** order to make payment to **Creditor**, irrespective of novation, see section 4, second paragraph above.

<sup>191</sup> The distinction is highlighted by Andreau, *Banking*, above n 30 at 44–46 who further points out an unsettled controversy as to whether entries were made to the *rationes* separately for (namely under the name of) each client or 'globally' in a strict chronological order as they were made.

<sup>192</sup> See section 7.2, first paragraph.

dismissed altogether. Indeed, there is nothing to suggest that between two counter-parties, sums entered to the ledger in opposing directions operated to offset one another so as to create a single liability of the net debtor to the net creditor for the balance due; automatic compensation was not a component of the theory of liability.<sup>193</sup> However, ‘parties engaged in continued mutual dealings’ may have struck periodic balances so as to novate their various monetary obligations entered on the ledger into a single contractual entry.<sup>194</sup> Arguably, it is in this sense that the literal contract, in providing a legal basis for a payment mechanism operated through the banking system, was a precursor to the legal framework that would govern the running account.

#### 8. ALL CARDS SHUFFLED: DELEGATION UNDER THE REFORM PROJECTS OF JUSTINIAN

Inasmuch as it necessarily required the use of legal proceedings, *litis contestatio* was awkward and inadequately responsive to the needs of commerce for simplicity and flexibility. In any event it was tied to a particular procedure that all but disappeared in the fourth century CE.<sup>195</sup> For their part, ‘[t]he ancient forms of *litterarum obligatio* became obsolete already in classical times.’<sup>196</sup> Similarly, by the time of Justinian’s reform projects in the sixth century CE, the *receptum argentarii* had also fallen into disuse.<sup>197</sup>

Accordingly, at the time of Justinian’s reform projects, the principal avenues for the execution of the delegation order were the *constitutum debiti alieni* and the *stipulatio*. The latter was taken to effect *novatio*, so as to operate as a perfect execution of the delegation. The effect of the former, as a species of *constitutum*, albeit having its own unique features, to generate the imperfect execution of the delegation order, had been less clear. In any event, the legal underpinning of both mechanisms, that of the *constitutum debiti alieni* and the novatory *stipulatio*, was radically affected in Justinian’s reform projects. Effectively, all cards were shuffled. Demarcation lines were abolished; in the process, any distinct mechanisms designed to achieve predictable and certain results disappeared.

Reform of the *constitutum debiti alieni* has taken into account not only the disappearance of the *receptum argentarii* but also the decline of the *constitutum proprii* that over the years fell equally into disuse.<sup>198</sup> With the disappearance of the *receptum argentarii*, the reformed *constitutum debiti alieni* expanded to

<sup>193</sup> For compensation, see text at nn 63–75, and thereabout above.

<sup>194</sup> Thomas, *Institutes*, above n 39 at 226 (Commentary on Justinian’s Institutes Book III, Title XXI).

<sup>195</sup> See section 7.1, first paragraph.

<sup>196</sup> Berger, above n 2 at 567.

<sup>197</sup> A point highlighted in Justinian’s Code, Book IV, Title XVIII, para 2 (trans to French by PA Tissot, as vol IX of *Corps de Droit Civil Romain*, Metz 1807, reprint 1979 in Aalen, Germany, by Sceintia Verlag) at 39.

<sup>198</sup> On this point, see eg Philippin, above n 92 at 111.



cover the entire scope of the *receptum argentarii* and was not limited to obligations to pay money or deliver a certain amount of fungible items. As well, with the decline of *constitutum proprii*, the underpinning legal theory of *constitutum debiti alieni* could be ‘cleaned’ of any vestige of, and made independent of, the legal theory underlying *constitutum*. In effect, the *receptum argentarii* was abolished, and became superseded by and absorbed into a newly reformed *constitutum debiti alieni*. The basis for the latter was however ‘elevated’ to that of a stipulation.<sup>199</sup>

At the same time, both stipulation and its novatory effects have undergone fundamental changes. First, as to novation, regardless of the prior state of law,<sup>200</sup> under Justinian’s reform, ‘there is a novation only whenever it is expressly provided by the contracting parties that they have entered into their contract for the novation of the previous obligation; in other circumstances the original obligation remains in force and the second is simply added to it.’<sup>201</sup> Hence, the existence of a stipulatory undertaking by **Paymaster** to **Creditor**, to pay to him the debt owed by **Debtor** to **Creditor**, is not necessarily to be taken as a novation resulting in the discharge of **Debtor**’s original obligation to **Creditor**. It is the terms of the express contract between **Paymaster** and **Creditor** that determine the existence or absence of novation and, hence, discharge.

Second, as to the *stipulatio*, the strictness of oral requirements was relaxed.<sup>202</sup> Informal written documents could be used to prove the existence of the *stipulatio*;<sup>203</sup> effectively, stipulation had become any agreement, however expressed, intended to take effect as stipulation, or in fact, any simple contractual obligation.<sup>204</sup> As a formal, verbal, unilateral, and *stricti juris* contract, stipulation ceased to exist.

Certainly, a system relying on oral contracts, whether formal or informal, has obvious evidentiary drawbacks. From this perspective, the introduction of written documents to prove oral contracts is undoubtedly a step forward. At the same time, a parallel improvement, that of the evolution of formal written contracts, could have been complementary and surely would not have been inconsistent with the oral contract system. Yet, such a parallel process materialized only in connection with notarized documents, with respect to which tight

<sup>199</sup> Justinian’s Code, Book IV, Title XVIII, para 2; Tissot, above n 197 at 39–41.

<sup>200</sup> See discussion in section 6.2 above.

<sup>201</sup> Justinian’s Institutes, Book III, Title XXIX, para 3a, reproduced in Thomas, *Institutes* above n 39 at 255.

<sup>202</sup> Justinian’s Institutes, Book III, Title XV, reproduced in Thomas, *Institutes* above n 39 at 207–08 and his Commentary, *ibid* at 208–10.

<sup>203</sup> For the entire process of the transformation of ‘the oral stipulation’ to ‘the stipulatory document’ see B Nicholas, ‘The Form of Stipulation in Roman Law’ (1953) 69 *LQR* 63 (Part I) and 233 (Part II). A more detailed exposition is by S Riccobono, *Stipulation and the Theory of Contract*, trans from Italian (with added notes) by JK Wylie (Amsterdam/Capetown: AA Balkema, 1957). See also Zimmermann, above n 15 at 68–94, and more briefly, Lee, above n 6 at 300–01 and Berger, above n 2 at 716.

<sup>204</sup> For this point, though still in connection with the exchange of a question and answer, see Digest 2.14.7.12, reproduced in Mommsen et al, above n 30, vol I at 64.

procedures, inappropriate for the dynamics of commercial transactions, had to be observed.<sup>205</sup>

In fact, the evolution of a parallel process for the emergence of formal written contracts with relaxed procedural requirements had not been impossible for the Romans. First, speaking of an 'obligation peculiar to foreigners' arising outside Roman law, already Gaius was familiar with 'an obligation by writing', or even more specifically, 'a literal obligation'.<sup>206</sup> Such an obligation appears to arise through the documents called in Greek 'chirographs' and 'syngraphs';<sup>207</sup> thereunder, without making a stipulation, 'a person writes that he owes or that he will give something'.<sup>208</sup> Such documents had thus been known to the Romans. Unfortunately however, the introduction of documentary evidence in the process culminating under Justinian's reforms was premised on the conversion of the formal abstract and unilateral written contract under either the *chirograph* or the *syngraph*, into a document evidencing an informal oral contract.<sup>209</sup> Thus, the narrow application of documentary evidence under Justinian's reforms 'exhausted' the basis for the emergence of a written formal contract in Roman law. Logically, however, the adoption of an oral contract evidenced by a written document ought not to have precluded a parallel adoption of an abstract formal written contract. Hence, the 'transformation' of the Greek formal contract, rather than its adoption, was not inevitable.

<sup>205</sup> For formal notarized documents under Justinian (and shortly before him), see AP Usher, *The Early History of Deposit Banking in Mediterranean Europe* (Cambridge, Mass: Harvard University Press, 1943) at 41–44.

<sup>206</sup> In the translation of De Zulueta, above n 73, Part I at 195. As already indicated above in n 167, Gaius is '[o]ne of the most renowned Roman jurists of the middle of the second century [CE] (born after Hadrian).' Berger, *ibid* at 481.

<sup>207</sup> De Zulueta above n 73, Part II at 166 explains that while the *chirograph* was a letter written by the debtor addressed to the creditor, the *syngraph* was a witnessed document sealed by both parties and deposited with an official. While the *chirograph* was signed by only by the debtor the *syngraph* was signed by both parties. See Berger, above n 2 at 388 (v. *Chirographum*) and 727 (v. *Syngraphe*). De Zulueta further asserts that according to the modern view, 'documents in either form could be abstract contracts, though purporting to be evidence of a debt from some (fictitious) *causa*, the commonest fiction being that of a loan'. *Ibid*. For the latter point, cf. JW Jones, *The Law and Legal Theory of the Greeks: An Introduction* (Oxford: Clarendon Press, 1956) at 220–22. But cf. eg Berger, *ibid* at 727, according to whom 'It is doubtful whether a *syngraphe* was valid if the obligation assumed therein by a party was not based on a real transaction.'

<sup>208</sup> Gaius' Institutes, Book III §134, Gordon and Robinson, above n 59 at 341. See also De Zulueta, above n 73, Part I at 195.

<sup>209</sup> For the transformation of the *chirograph*, see eg Berger, above n 2 at 338. On his part, Platon, above n 88 at 119–22 discusses the transformation of the *syngraph*. For other accounts (that in fact confirm lack of uniformity on some points) see G Humbert, 'Chirographum' in C Daremberg and E Saglio (eds), *Dictionnaire Des Antiquités Grecques et Romaines* (Paris: Librairie Hachette, 1887; reprint Graz Austria: Akademische Druck – U Verlagsanstalt, 1962) at 1103, and L Beauchet, 'Syngraphé' in E Saglio and E Pottier (eds), *Dictionnaire des Antiquités Grecques et Romaines* (Paris: Librairie Hachette, 1911, reprint Graz Austria, Akademische Druck – U Verlagsanstalt, 1969) vol IV Part 2 at 1587. See also W Smith (ed), *A Dictionary of Greek and Roman Antiquities* (London: John Murray, 1878) at 271 (v. 'Chirographum' by B Jowett) and 1086 (v. 'Syngraphe' by CR Kennedy). For the chirograph as a letter containing a mere acknowledgement of a debt see Digest 2.14.47.1, reproduced in Mommsen et al, above n 30, vol I at 72, and a brief discussion in Andreau, *La Vie* above n 1 at 567.

Similarly, the reduction of the *constitutum* exclusively into a written novatory formal contract seemed to have been within reach. Such a reduction could have been established by a simplified procedure formed by the mere delivery of the document to the creditor, as was the procedure for the delivery of the letter (*epistola*) under earlier law.<sup>210</sup> Regrettably, however, the opportunity for bringing this process to a fruitful conclusion had also been missed.<sup>211</sup> In the final analysis, formal written stipulations, binding by means of simplified procedures, neither preceded nor emerged from Justinian's reform projects and have not been part of Roman law throughout any of its various stages.

Justinian's reform on novation and stipulation is usually treated favourably; what is highlighted is not only the elimination of contentious aspects of prior law,<sup>212</sup> but also the liberation of Roman law from the shackles of excessive formalism.<sup>213</sup> Nevertheless, taking as a given the existence of drawbacks in prior law, as well as the overall positive developments of the general law of obligations, improvement was not the only result of Justinian's reform. In the reform process, both the *stipulatio* and *constitutum* were significantly diluted. Being transformed into a regular stipulation, the *constitutum* lost its character as a promise subject to immediate unconditional enforcement. For its part, not having an automatic novatory effect, the stipulation became an ordinary contractual term.

In making novation wholly dependent on the intention of the parties as expressed in any specific case, Justinian's reform arrested the evolution of payment mechanisms. Prior to the reform, the choice of any particular mechanism automatically determined the existence or absence of novation, autonomy, and discharge, at least as a matter of the presumed intention of the parties. By contrast, in bowing to the actual intention of the parties in any given case, and thereby reinforcing an important principle of the law of contract, the reform nevertheless sacrificed the evolution of a process for the emergence of greater certainty in legal principles governing payment mechanisms. It is certainly the case that the reform is of enormous importance in commercial law. The elimination of excessive rigidity has, so far, been for the better as the development of the general law of contract is concerned. Yet, formalism plays an important role in providing certainty. By shedding *all* vestiges of formalism, the pendulum swung too far. In the process, the evolution of a legal framework facilitating the operation of payment mechanisms by means of the execution of a delegation order had been undermined.

<sup>210</sup> For the *Epistula* see n 96 above. But cf Platon, above n 88 at 193, pointing out at a reverse process, under which ascent of the *Epistula* caused the *constitutum* to lose its unique identity.

<sup>211</sup> Cf Platon, *ibid* at 193 who points out both the potential and the erosion of the *constitutum* as a forerunner of the bill of exchange, a point to be revisited below in ch 8, section 4 of this book.

<sup>212</sup> See eg Thomas, *Institutes*, above n 39 at 257 (Commentary on Justinian's Institutes Book III, Title XXIX).

<sup>213</sup> See eg Zimmermann, above n 15 at 70–71.

## 9. CESSION: AN ALTERNATIVE TO DELEGATION

The execution of a delegation requires the consent of **Paymaster**;<sup>214</sup> this is true for both perfect and imperfect execution, and not only for an absolute (or pure) delegation but also for a qualified delegation resulting in the transfer (cession) of a passive or active obligation.<sup>215</sup> That is, **Paymaster**'s consent is required for **Paymaster** to incur with respect to **Creditor**,

- (i) a novated 'abstract' obligation (in an absolute delegation);
- (ii) **Debtor**'s original obligation to **Creditor** (in a qualified delegation resulting in the transfer of a passive obligation); as well as
- (iii) his (**Paymaster**'s) own obligation originally owed to **Debtor** (in a qualified delegation resulting in the transfer of an active obligation).

Moreover, in the context of novation by stipulation under classical law, to be effective, **Paymaster**'s consent had to be given in the presence of **Creditor**,<sup>216</sup> which posed difficulties in the use of delegation for the transfer of funds between distant parties.<sup>217</sup>

As an alternative to a qualified delegation resulting in the transfer of an active obligation, in order to bypass the need of obtaining **Paymaster**'s consent, **Debtor** may authorize **Creditor** to collect from **Paymaster**, the debt owed by **Paymaster** to **Debtor**, and keep the proceeds. In such a case, **Debtor** instructs **Creditor** to collect from **Paymaster**; on the basis of this authority, **Creditor** demands payment from **Paymaster**. In the process, **Paymaster** becomes bound to pay **Creditor** **Paymaster**'s debt to **Debtor**, irrespective of whether he, **Paymaster**, has given his consent in any way. Under modern law terminology, **Debtor**'s authorization effects an assignment by **Debtor** to **Creditor** of **Paymaster**'s debt owed to **Debtor**; in the process, **Debtor** is the creditor/assignor, **Paymaster** is the obligor or account debtor, and **Creditor** is the assignee. Assignment by **Debtor**, of the debt owed to him by **Paymaster**, is in discharge of **Debtor**'s debt to **Creditor**. In the context of the present discussion, the authorization given by **Debtor** to **Creditor** to collect from **Paymaster** effectively generates an order to pay, given to **Paymaster**, though by **Creditor**, and yet under the authority of **Debtor**; hence this payment order falls into the scope of our discussion.

Under that alternative, as in the case of a qualified delegation consisting of the transfer of a credit or active obligation,<sup>218</sup> **Paymaster** remains liable on his own original obligation, though to a new creditor. **Paymaster** may thus raise against **Creditor** defences that would have been available to **Paymaster** against

<sup>214</sup> For the indispensability of **Paymaster**'s 'voluntary act' for delegation see eg Maxwell, above n 2 at 63.

<sup>215</sup> The distinction is dealt with in section 6.2 above.

<sup>216</sup> This stems from the face-to-face requirement for a valid stipulation. See section 6.1 above.

<sup>217</sup> Difficulties could be overcome, however, where – other than in **Creditor**'s location – either **Paymaster** or **Paymaster**'s correspondent was present in **Debtor**'s location. See section 10.3 below.

<sup>218</sup> See discussion in section 6.2 above.

**Debtor**, and **Creditor** becomes entitled to **Paymaster's** securities given to **Debtor**. And yet, unlike under a qualified delegation, this is achieved without novation, that is, with no binding agreement by **Paymaster** to redirect payment to a new creditor; no new obligation by **Paymaster** is created in the course of implementing **Debtor's** design in authorizing **Creditor** to collect from **Paymaster**. Rather, **Debtor's** authorization generates the *cessio*, that is, the transfer to **Creditor** of **Debtor's** right against **Paymaster** to the performance of **Paymaster's** obligation to **Debtor**.<sup>219</sup> While *cessio* may literally be translated as cession,<sup>220</sup> as indicated, the term used in English to denote the transfer of a creditor's rights is 'assignment'.<sup>221</sup> Even though both terms may thus be used interchangeably below,<sup>222</sup> the preferred one is 'assignment'.

The position described in the preceding paragraph did not come about overnight; rather, it is the result of an evolutionary process.<sup>223</sup> To begin with, Roman law did not consider a monetary debt to be an item of property, that is, an asset, capable of being voluntarily conveyed or transferred from one person to another under the usual means for the transfer of property.<sup>224</sup> Cession, as an outright transfer of a debt owed, has thus developed gradually.

Originally, under 'a variant of procedural representation',<sup>225</sup> **Debtor** either appointed **Creditor** to act as his representative or gave **Creditor** a mandate in **Creditor's** own interest (*mandatum in rem suam* or *procuratio in rem suam*) to sue and recover from **Paymaster**. Acting on the authorization, **Creditor** could sue **Paymaster** in **Debtor's** name, seeking a remedy under which **Paymaster** was to be 'condemned' to pay **Creditor**.<sup>226</sup> Against the impossibility of transferring

<sup>219</sup> For *cessio* see Berger, above n 2 at 387.

<sup>220</sup> See eg Zimmermann, above n 15 at 58.

<sup>221</sup> See eg BA Garner (ed in chief), *Black's Law Dictionary*, 9th edn (St Paul Minn: West, 2009) at 136 v. 'assignment'.

<sup>222</sup> As eg by Lee, above n 6 at 410. Note however that between the two expressions, only cession (*cessio*) appears in the Roman sources. Zimmermann, above n 15 at 58, fn 180.

<sup>223</sup> Evolution is outlined by Lee, *ibid* at 410–12; Nicholas, above n 5 at 200–01; and Zimmermann, *ibid* at 58–64. For a detailed account see Demangeat, *Droit Romain* above n 138 at 13–33. See also J Duponchel, *De la Cession d'Actions en Droit Romain. Du Titre à l'Ordre et des Conséquences qui s'y Rattachent en Droit Français* (Versailles: Imprimerie de Beau Jeune, 1870) at 3–10. But cf Gide, above n 2, whose account (throughout the entire book) tends to de-emphasize cession as a break-away from novation and delegation but rather treats cession as anchored in them. In principle however, his account varies from the conventional wisdom on matters of assessment rather than of facts.

<sup>224</sup> One reason, stated by Roby, above n 2 at 45, is that '[a]n obligation is not susceptible, as a thing is, of bodily transference for the possession of one to the possession of another.' For another reason see eg Zimmermann, *ibid* at 58–59, who highlights the 'highly personal' nature of an obligation and who further explains that 'the action arising from [a debtor's] obligation hinges on the bones and entrails of the creditor and can no more be separated from his person than the soul from the body.' For a comprehensive discussion, see Gaudemet, above n 105 at 154–95.

<sup>225</sup> Nicholas, above n 5 at 200. See also Dannenbring, above n 2 at 271–72 and Zimmermann, *ibid* at 61.

<sup>226</sup> See Gaius' Institutes Book IV §§83–84 (the appointment by a litigant of either a *cognitor* (namely representative), or a *procurator* (namely a mandatary) to substitute him in court) and §86 (debtor is 'condemned' to pay debt he owes to creditor to creditor's representative or mandatary); Gordon and Robinson, above n 59 at 469–73. Unlike a *procurator*, a *cognitor* was appointed in court in the presence of the other litigant. *Ibid*.

anything other than ‘corporeal things’ from one person to another,<sup>227</sup> and specifically to meet drawbacks in the novatory stipulation,<sup>228</sup> particularly, the need to procure **Paymaster**’s consent, and the extinction of securities, this was ‘a praetorian adaptation of a civil law action.’<sup>229</sup> Authorization however further permitted **Creditor** to keep, and not account to **Debtor**, whatever proceeds **Creditor** collected from **Paymaster**. The authorization was called ‘*mandatum ad agentum*’; strictly speaking, however, it was not a mandate, since a mandate cannot be concluded wholly in the interest of the mandatary.<sup>230</sup>

Until the post-classical era, **Creditor**’s appointment and authorization by **Debtor** did not pass on to **Creditor** **Debtor**’s claim towards **Paymaster**; thus, notwithstanding the authorization in **Creditor**’s interest, **Debtor** remained in control of his claim against **Paymaster**. Control passed on to **Creditor** only in the context of the lawsuit against **Paymaster**, brought by **Creditor** in the name of **Debtor**, under **Debtor**’s authority, and as of the joinder of issue (*litis contestatio*).<sup>231</sup> In the era of the formulary procedure, which ceased to exist by the fourth century CE,<sup>232</sup> this was the stage of the crystallization of the issues in the litigation. At that point, the judge was directed to ‘condemn’ **Paymaster** to pay **Creditor** on the basis of the debt owed by **Paymaster** to **Debtor**, so that *novatio necessaria*, or novation by the operation of law, was said to occur.

Effectively then, *litis contestatio* passed on to **Creditor** the debt owed by **Paymaster** to **Debtor**. In the process leading to a cession carried out by means of *litis contestatio*, **Debtor** appointed **Creditor** as **Debtor**’s representative in suing **Paymaster**. In contrast, as discussed in section 7.1 above, in the process leading to novation by means of *litis contestatio*, **Debtor** appointed **Paymaster** to act as **Debtor**’s representative as a defendant in an action to be brought by **Creditor**. **Paymaster**’s consent was required in the latter but not the former case. Strictly speaking, in the former case, that of a cession, the effect of *litis contestatio* was not novation, as ‘[i]t did not derive from the agreement of the parties’.<sup>233</sup> Effectively, however, it operated very much like a qualified delegation, of the type involving

<sup>227</sup> The transmission by death of the inheritor’s debts as part of the transmission of his entire estate to his heirs and other instances of transmission as an incident to the transmission of an entire estate are distinguishable. This is so notwithstanding Gide’s view to the contrary, above n 2 at 238. See Demangeat, *Droit Romain*, above n 138 at 4–12.

<sup>228</sup> For bypassing the inalienability of debts, not being ‘corporeal things’, either by a novatory stipulation between the debtor and would be ‘transferee’, or an action by the ‘transferee’ in the creditor’s name, see Gaius’ Institutes Book II §§38–39, Gordon and Robinson, above n 59 at 139–41.

<sup>229</sup> Lee, above n 6 at 411, and see also his discussion on transferred actions at 433–34. For the Praetor’s role in the development of Roman law see n 87 above and references therein.

<sup>230</sup> See eg Zimmermann, above n 15 at 422, as well as Gide above n 2 at 467.

<sup>231</sup> According to Berger, above n 2 at 566, this is ‘[t]he final act in the proceedings . . . , by which, after the appointment of the judge . . . , the controversial issues are established and submitted to the latter for the examination of the facts and for judgment.’ Nicholas, above n 5 at 25 characterizes this stage as ‘the moment by reference to which the issues between the parties must be decided and after which there can be no alteration of the pleadings and no fresh action on the same issue.’

<sup>232</sup> See section 7.1, first paragraph above.

<sup>233</sup> Thomas, *Institutes* above n 39 at 257 (Commentary on Justinian’s Institutes Book III, Title XXIX). See also Lee, above n 6 at 416. For taking such views to be limited to this situation (and not the one discussed in section 7.1) see section 7.1, last paragraph above.

the novation by means of a change in the creditor to whom **Paymaster** owed. It was the transfer (*cessio* or cession) of a credit or active obligation, under which **Paymaster** became obligated to pay **Creditor** the debt owed by **Paymaster** to **Debtor**.<sup>234</sup> **Paymaster** remained liable on his own original obligation, though to a new creditor; **Paymaster** could thus raise against **Creditor** any defence that would have been available to **Paymaster** against **Debtor**, and **Creditor** became entitled to **Paymaster's** securities given to **Debtor**.<sup>235</sup>

In connection with **Creditor's** action as **Debtor's** representative against **Paymaster**, it is only as of the joinder of issue (*litis contestatio*) that **Creditor** is said to have 'made the right his own'.<sup>236</sup> Until that point, **Creditor's** claim could be defeated by the revocation of authority by **Debtor**, **Debtor's** death, or even discharge given by **Debtor** to **Paymaster**. Indeed, it was possible for **Creditor** to procure from **Debtor** a *cautio*,<sup>237</sup> in the form of a promise by way of stipulation from **Debtor**, to which a penalty could be attached, not to undermine collection by **Creditor** to **Creditor's** own benefit; this however did not preclude **Debtor** from effectively breaking his promise (subject of course to liability for the payment of the penalty), and could not protect **Creditor** against events outside **Debtor's** control such as **Debtor's** death or insolvency.

As of the time of Emperor Antoninus Pius (138–161 CE) **Creditor's** position gradually improved and became independent of *litis contestatio*. By the time of Justinian, **Creditor** had not been required to sue **Paymaster** as a *cognitor* or *procurator* for **Debtor**,<sup>238</sup> rather, **Creditor** was allowed to maintain an *actio utilis*<sup>239</sup> in his own name, and even when the 'mandate' had been determined by **Debtor's** death or revocation.<sup>240</sup> By either giving **Paymaster** a formal notice, called *denuntiatio*,<sup>241</sup> or receiving from him part payment, **Creditor** assumed

<sup>234</sup> As discussed in section 6.2, above.

<sup>235</sup> Thomas, *Institutes* above n 39 at 257 (Commentary on Justinian's Institutes Book III, Title XXIX), further states that such imperfect novation 'did not cancel the effects of *mora*.' Elsewhere (*ibid* at 204, Commentary on Justinian's Institutes Book III, Title XIV) he defines *mora* as the blamable failure to discharge an obligation at the proper time or place or in the proper place, which effectively means the unjustified default.

<sup>236</sup> Lee, above n 6 at 411. Presumably, it is in the anticipation of this stage that Zimmermann speaks, above n 15 at 61, of the authorization given by **Debtor** to **Creditor** as to sue **Paymaster** 'in his own name'.

<sup>237</sup> *Cautio* denotes an obligation assumed as a guarantee for the execution of an already existing obligation or of a duty not protected by law. It also denotes a written confirmation of an obligation. See in general, Berger, above n 2 at 384–85. In the context of the text above, it is presumably a form of a warranty or indemnity undertaking.

<sup>238</sup> See nn 161 and 216 above.

<sup>239</sup> As 'an adaptation or extension of an existing action' an *actio utilis* is a praetorian action which usually denotes 'a modification of a civil law formula . . . or to the application of a civil law formula to a new state of facts or to persons not entitled to make use of it.' Lee, above n 6 at 435. For the formula, as '[a] written document by which in a civil trial authorization was given to a judge . . . to condemn the defendant if certain factual or legal circumstances appeared proved, or to absolve him if this was not the case', see Berger, *ibid* at 474. See also Lee, *ibid* at 442–56.

<sup>240</sup> For **Creditor's** *actio utilis* as contrasted with, and being more advantageous than, **Creditor's** 'direct' action as *procurator* for **Debtor**, see Duponchel, above n 223 at 29–32.

<sup>241</sup> According to Berger, above n 2 at 431 *Denuntiatio* means to give notice, to intimate, or announce. Duponchel, *ibid* discusses at 5–7 issues relevant to the notice.



full control of **Debtor's** claim against **Paymaster**, which precluded **Debtor** from accepting a settlement from **Paymaster** or otherwise giving him a discharge.<sup>242</sup> It is only at this point that Roman law is said, at least in hindsight,<sup>243</sup> to 'eventually . . . have arrived at an effective system of assignment [of debts]',<sup>244</sup> under which the transfer to **Creditor** of **Debtor's** claim against **Paymaster** is fully recognized and protected.

Nevertheless, strong doubts arose in the post-Justinian era; they were based on confusion caused by the juxtaposition by Justinian as 'existing laws' of 'the various stages through which the development of assignment had passed.' In civilian legal systems drawn on the Romanist tradition, doubts persisted until the middle of the nineteenth century. It is only as of then that 'the tide was turning' so as to accord full recognition and protection to **Creditor** as a transferee in full control of **Debtor's** right against **Paymaster**.<sup>245</sup> As a matter of history, what was doctrinally achievable in the sixth century CE, came to be fully recognized only 13 centuries later.

Throughout the development, leading to the recognition of **Creditor's** full control of the right to enforce the claim against **Paymaster** under the authorization or assignment from **Debtor**, **Creditor** nevertheless has been enforcing **Paymaster's** original obligation to **Debtor**, which has not been novated, discharged, or transformed in the process.<sup>246</sup> To that end, **Creditor** remains entitled to the benefit of all securities attached to **Paymaster's** obligation towards **Debtor**; yet, by the same token, **Creditor** is subject to all defences available to **Paymaster** on his obligation to **Debtor**.<sup>247</sup> In turn, on the basis of the effective assignment, **Debtor** has lost his power to discharge **Paymaster**, so that **Paymaster's** obligation, originally incurred to **Debtor**, is fully discharged by **Paymaster's** payment to, or any settlement given by, **Creditor**.<sup>248</sup>

The explanation of **Debtor's** discharge to **Creditor** in the 'assignment' process is, however, less straightforward. Inasmuch as **Paymaster** pays to **Creditor** **Paymaster's** own debt to **Debtor**, and not **Debtor's** debt to **Creditor**, by itself,

<sup>242</sup> Having received such notice, **Paymaster** could 'possibly' raise a defence against **Debtor's** action based on **Debtor's** fraud (*exceptio doli*). See Zimmermann, above n 15 at 62.

<sup>243</sup> This qualification is based on the immediately following paragraph and is not that of Nicholas.

<sup>244</sup> Nicholas, above n 5 at 201. Yet the transferability of a debt has remained subject to public policy restrictions, eg 'in the case where the transfer was made in order to vex a debtor with a more powerful creditor,' or otherwise against 'persons that made a trade of harassing debtors.' See Hunter, above n 2 at 628.

<sup>245</sup> For quoted language and discussion see Zimmermann, above n 15 at 63–64.

<sup>246</sup> The full effect of the cession is dealt with by Duponchel, above n 223 at 30–42.

<sup>247</sup> Where **Paymaster** is a banker, there may not be any securities or else, their added benefit may be, at the most, marginal. At the same time, the subjection of **Creditor** to **Paymaster's** defences may prove to be detrimental; the emergence and development of devices to overcome the assignee's subjection to defences (such as through the use of negotiable instruments and waiver of defence clauses) is however, relatively speaking, quite recent. See below n 289 and text around it.

<sup>248</sup> For the obligor (**Paymaster**)'s ultimate position see detailed analysis by Demangeat, *Droit Romain*, above n 138 at 60–80 who further discusses at 81–85 the obligor's protection against an abusive assignee.



payment by **Paymaster** to **Creditor** cannot be seen as discharging **Debtor's** debt to **Creditor**. Also, to the extent that **Debtor** waived his right to the proceeds collected by **Creditor** from **Paymaster**, **Debtor** may not use his (non-existent) claim to such proceeds in an offset or compensation against **Creditor's** claim against him.<sup>249</sup> Arguably, in the absence of a 'contrary stipulation', in the form of *acceptilatio*<sup>250</sup> between **Debtor** and **Creditor**, under which **Creditor** is to release **Debtor**, **Debtor** may defend **Creditor's** claim, effectively for double payment, pleading release on the basis of 'bargain agreed', *pactum non petendo*, namely, an informal agreement not to sue, which may be either express or inferred from the circumstances.<sup>251</sup> Or else, **Creditor's** agreement to the assignment, which may be either express or implied, as, for example, from his collection from **Paymaster**, may be treated as an agreement to a substituted mode of performance, *datio in solutum*, releasing **Debtor** altogether against him.<sup>252</sup> Evidentially, **Creditor's** agreement, emerging from the terms of his acceptance of the assignment, however theorized, is to further determine whether and to what extent the cession is to be repudiated upon the default of **Paymaster** in payment to **Creditor** (of the debt originally owed by **Paymaster** to **Debtor**). Upon such repudiation, recourse becomes available to the **Creditor** against **Debtor** and to **Debtor** against **Paymaster**.<sup>253</sup>

Indeed, under modern law, an assignee takes the assigned debt with the securities attached to it, and subject to the obligor's defences against the assignor. The assignee may not enforce the assigned debt prior to the maturity of the obligor's obligation; on his part, the obligor is obliged to pay the assignee only upon being notified of the assignment. In other respects, rules governing the assignment of debts depend on the category into which the assignment falls. Analytically, the assignment of a debt may be:

- (i) for collection only with the full accountability of the assignor to the assignee for the proceeds collected from the obligor;
- (ii) by way of gift; or
- (iii) for value. Value may include the payment of a preexisting debt, as it is in our case. An assignment for value may either be outright or by way of security.<sup>254</sup>

<sup>249</sup> For compensation, text at nn 63–75 above.

<sup>250</sup> For this mode of discharge see Lee, above n 6 at 413, and Roby, above n 2 at 55–59.

<sup>251</sup> See eg Roby, *ibid* at 61–64. But cf Lee *ibid* at 414–15 noting that until Justinian an informal agreement could not discharge a debt created by contract, except that it could be used in defence to an action brought contrary to it.

<sup>252</sup> For a substituted performance as a basis for either actual discharge or a plea of fraud see eg Roby, *ibid* at 51 and Lee, *ibid* at 413.

<sup>253</sup> Presumably, with the 'renewal' of **Debtor's** obligation to **Creditor**, personal and real securities attached to it are to become again effective. Certainly, securities attached to **Paymaster's** obligation remain intact.

<sup>254</sup> For a comprehensive review of the law of assignment of debts in the various legal systems, see H Kötz, 'Rights of Third Parties, Third Party Beneficiaries and Assignments' in A Von Mehren (chief ed), *Contracts in General*, vol VII of U Drobnig and K Zweigert (responsible eds), *International Encyclopedia of Comparative Law* (Tübingen: JCB Mohr, 1992) ch 13.

An outright assignment for value is tantamount to the sale to the assignee of the assignor's right against the obligor. Under an outright assignment, the assignee becomes entitled to recover from the obligor. Whether, and to what extent, following the assignment, the assignee is to have recourse against the assignor is a matter to be mutually agreed between the assignor and the assignee. Typically, the extent of the assignee's recourse against the assignor is the amount of the obligor's debt. Prima facie, the treatment of the outright assignment as a 'sale' to the assignee, of the obligor's debt to the assignor, appears to suggest the assumption by the assignee of the entire risk of default by the obligor and hence the exoneration or release of the assignor.<sup>255</sup>

Nevertheless, this presumption may be reversed by an agreement to the contrary between the assignee and assignor. Thus, the assignee may have taken from the assignor the obligor's debt to the assignor, subject to a limited or full recourse against the assignor. In such a case, the assignor either becomes or remains liable to the assignee.<sup>256</sup> Stated otherwise, (a) whether the assignee may recover from the assignor, (i) until full payment by the obligor, (ii) only as of the obligor's default, or (iii) at all, as well as (b) whether securities originally given to the assignee by the assignor may be enforced by the assignee in pursuing his recourse against the assignor, are matters to be governed by an agreement between the assignor and assignee.

Conversely, an assignment by way of security is a secured transaction; it confers on the assignee a mere security interest in the debt owed by the obligor to the assignor.<sup>257</sup> In the absence of default by the assignor on the debt owed by him to the assignee, and secured by the obligor's debt, the assignee does not become entitled to recover from the obligor, who is to pay the assignor. Under an assignment by way of security, until fully paid, the debt owed by the assignor to the assignee and secured by the obligor's debt to the assignor, remains outstanding, typically together with all other securities attached to it. The assignee is to recover from the obligor only upon the assignor's default, and up to the amount owed by the assignor to the assignee. Securities attached to the debt owed by the obligor to the assignor are not affected in the process.<sup>258</sup>

In the setting under the present discussion, the assignor-**Debtor** pays the assignee-**Creditor** by making available to **Creditor** a debt owed by the obligor-**Paymaster** to the assignor-**Debtor**. This is a case of an outright assignment of a debt, owed to the assignor **Debtor** by an obligor-**Paymaster**, in payment of an

<sup>255</sup> For the analogous passage of risk with the transfer of property to a buyer of goods under a contract of sale under modern law see eg Ontario *Sale of Goods Act*, R.S.O. 1990, c. S.1, s 21.

<sup>256</sup> For various arrangements under modern law and practice see eg the pre-2001 *Official Texts of the American Uniform Commercial Code* (eg 1962, 1972, and 1978), Official Comment 1 to §9-308.

<sup>257</sup> This indeed is under the modern legal perspective of Article 9 of the *American Uniform Commercial Code* (1990, as amended 2002) in the US and *Personal Property Security Legislation* in Canada (eg, in Ontario, see the *Personal Property Security Act*, R.S.O. 1990, c. P.10). Such an option may have not existed under Roman law and practice and is discussed here for the completion of the analytical picture.

<sup>258</sup> For a detailed analysis under modern law see B Geva, 'Security Interests in Secured Obligations' (1982), 60 *Canadian Bar Review* 151.

existing debt owed by the assignor-**Debtor** to the assignee-**Creditor**. Hence, the assignment entitles the assignee-**Creditor** to recover from the obligor-**Paymaster**, subject to **Paymaster**'s defences against **Debtor** and with the benefit of **Paymaster**'s securities given to **Debtor**. There is however no automatic effect to this assignment on the debt owed by the assignor-**Debtor** to the assignee-**Creditor**. Particularly, four outstanding issues may be identified:

- First, following the assignment, does the assignee-**Creditor** remain entitled to recover not only from the obligor-**Paymaster**, but also from the assignor-**Debtor**?
- Second, if the latter, may the assignee-**Creditor** recover from the assignor-**Debtor** any time until full satisfaction of the debt the assignor-**Debtor** owes to the assignee-**Creditor**, or only as of the time the obligor-**Paymaster** defaults?
- Third, following the assignment, in enforcing his right against the assignor-**Debtor**, if and as provided under their agreement, does the assignee-**Creditor** remain entitled to enforce securities given to him by the assignor-**Debtor** to secure **Debtor**'s debt to **Creditor**?
- Fourth, is recourse available to the assignee-**Creditor** against the assignor-**Debtor**? If and when recourse is available, what is the ceiling of assignor-**Debtor**'s liability?

All such matters are to be governed by an agreement reached between the assignor-**Debtor** and the assignee-**Creditor**. In the absence of an express agreement, the issue becomes that of either ascertaining the parties' intention or searching for the existence of a presumption to that effect. No clear or adequate guidance appears to emerge from the sources. Indeed, in discussing the respective mutual obligations of the assignee and assignor, Demangeat distinguishes between the assignment for value<sup>259</sup> and the assignment by way of gift. He treats the former as tantamount to an outright sale without recourse.<sup>260</sup> However, he does not discuss variations, whether by agreement or course of dealing. For his part, Duponchel<sup>261</sup> distinguishes between *cessio* and *assignatio*; the former is effectively an assignment without recourse, and the latter, which can be translated as 'assignment',<sup>262</sup> is an assignment with recourse. As Duponchel explains,

<sup>259</sup> An assignment for value is broad enough to cover both an assignment in payment of an existing debt (or an antecedent obligation), and not only an assignment for fresh value.

<sup>260</sup> Demangeat, *Droit Romain*, above n 138 at 49–60.

<sup>261</sup> Above n 223 at 10.

<sup>262</sup> Terminology on the point is however quite confusing. Eg, in Scotland 'assignation' is used to denote 'assignment'. See eg S Styles and NR Whitty (eds), *Glossary of Scottish and European Union Legal Terms and Latin Phrases*, 2nd edn (Edinburgh: The Law Society of Scotland and Lexis-Nexis UK, 2003), defining at 17 'assignation' as 'the act of transferring rights in incorporeal moveable property from one party to another' or 'the document transferring such rights.' See also *British Linen Co v Hay & Robertson and Brown* (1885) 22 SLR 542 (First Division); and J Bouvier, *A Law Dictionary: adapted to the constitution and laws of the United States of America, and of the several states of the American Union*, rev 6th edn (1856), online: Constitution Society [www.constitution.org/bouv/bouvier.htm](http://www.constitution.org/bouv/bouvier.htm), defining 'assignation' in Scots law as '[t]he ceding or yielding a thing to

what discharges **Debtor's** debt to **Creditor** is **Paymaster's** debt to **Debtor** in a cession, and actual payment by **Paymaster** (or **Debtor**) to **Creditor** in an assignation.<sup>263</sup> However, Duponchel does not discuss the default position, which exists in the absence of a clear agreement on the recourse point. Due to the infrequent use of, as well as reference to, *assignatio* in the context of Roman law and practice,<sup>264</sup> I restrict the use of the term only to contrast it with *cessio*; otherwise, *cessio* or cession will be used to cover any type of outright assignment, that is, whether it is with or without recourse.

In any event, as will be recalled, in connection with the execution of a delegation order, in dealing with the impact of **Paymaster's** undertaking to pay **Creditor** the debt owed by **Debtor** to **Creditor**, the choice in Roman law has been between the continued existence of the debt owed by **Debtor** to **Creditor** in an imperfect execution of the delegation, and the extinction or discharge of this debt in the perfect execution of the delegation. No middle ground of suspension or conditional discharge of **Debtor**, until default by **Paymaster**, appeared to exist.<sup>265</sup> Implicitly, in the absence of a clear position stated as to the possibility of a conditional discharge of **Debtor**, until default by **Paymaster**, this may well have been the choice in Roman law also here. Thus, following the assignment by assignor-**Debtor** to assignee-**Creditor** of the debt owed to **Debtor** by obligor-**Paymaster**, the choice may well have been between the continued existence or extinction of **Debtor's** obligation to **Creditor**.

## 10. ROMAN LAW AND PRACTICE: MULTIPARTITE APPLICATIONS OF THE MECHANISMS

### 10.1 Introduction

Each mechanism analysed in this chapter is basically a three-party payment mechanism, facilitating, through the involvement of a paymaster, the discharge of a debt other than by payment in specie from a debtor to his creditor. Yet, these mechanisms are also adequately elastic and expandable to accommodate

another of which intimation must be made.' At the same time, the Swiss Code of Obligations distinguishes (in French) between '*assignation*' and '*cession*' (arts 466 and 164 respectively), the former being an order or authorization to pay and the latter being an assignment of a right.

<sup>263</sup> Indeed, as Duponchel points out (above n 223 at 10), in an assignation **Creditor** does not assume the risk of **Paymaster's** default and as such his position, unlike under a cession, is analogous to that of a mandatary. Nevertheless, inasmuch as collection by **Creditor** from **Paymaster** is for his own benefit and not that of **Debtor**, the assignation is not a true mandate.

<sup>264</sup> Infrequent use in Rome is pointed out by P Sorbier, *L'Ancien Contrat d'Assignation de Créance; ou Délégation Commerciale à Titre de Nantissement: Son Emploi dans les Banques pour Garantir un Compte Courant* (Paris: Imprimerie de France, 1937) at 22 (where the author adopts a similar explanation of the contract of assignation as that of Duponchel and goes on, at 22–23, to point out narrow circumstances in which the paymaster can get his discharge by paying the debtor even after the assignation). The term '*assignatio*' does not appear at all in Berger, above n 2.

<sup>265</sup> See section 6.2 above.

situations involving more than three parties. Particularly, as demonstrated below, they can be used for the circulation of credit and payment between distant parties. As such, these mechanisms further contributed to the smooth operation of credit and payment facilities in the Roman Empire by reducing both the number of cash payments and the physical transportation of money. Indeed, the facilitation of such mechanisms is an indication of the important role the Roman legal system played in the economy of the Empire in mitigating economic uncertainty and reducing transaction costs.<sup>266</sup>

However, it is premature to speak of multilateral clearing and settlement among bankers during the Roman period.<sup>267</sup> Throughout that entire time, neither an inter-city nor intra-city multilateral interbank clearing and settlement system had existed. Interbank payments took place through correspondent accounts, namely deposit accounts held by one banker with another, particularly in the same city,<sup>268</sup> but as discussed in section 10.3 below, also in different cities. Even the analogy of each mechanism analysed in this chapter to the cheque or bill of exchange of subsequent eras<sup>269</sup> has its limits. First, the afore-said analogy blurs the distinction between the delegation, under which the payment order is issued directly by **Debtor** to **Paymaster**, and the cession, in which the payment order addressed to **Paymaster** is nevertheless issued by **Debtor** to **Creditor**, who is to present it to **Paymaster**. The cheque or bill of exchange bears greater resemblance to the latter than to the former. Second, as discussed below, the circulation of credit effectuated by the Romans through the use of contemporary mechanisms fell short of the circulation of instruments, such as cheques and bills of exchange in later eras, which had not been known to the Romans.

## 10.2 Circulation of Credit

Credit can be circulated where, having become entitled to receive payment from **Paymaster**, the delegate-**Creditor** re-delegates **Paymaster** to make payment to E (a third party), who may be **Creditor**'s own creditor. In such a case, 'double delegation' is involved; first by **Debtor** to **Paymaster** to pay **Creditor**, and second, by **Creditor** to **Paymaster** to pay E. In principle, E may further delegate **Paymaster** to pay F (another third party), who may be E's creditor, and so on down an infinite chain.<sup>270</sup> In each such case, **Paymaster** will ultimately pay the

<sup>266</sup> For this view on the role of Roman law, see in general T Terpstra, 'Roman Law, Transaction Costs and the Roman Economy: Evidence from the Sulpicii Archive' in Verboven et al, *Ancient World* above n 115 at 345.

<sup>267</sup> Notwithstanding Maxwell, above n 2 at 111.

<sup>268</sup> See Andreau, *Banking*, above n 30 at 43, who specifically claims that in the Roman world '[t]here was no system of institutionalized compensation between banks of the same city.'

<sup>269</sup> On this point, see particularly Maxwell, above n 2 at 109–12.

<sup>270</sup> K Verboven, 'Faeneratores, Negotiatores and Financial Intermediation in the Roman World (Late Republic and Early Empire)' in Verboven et al, *Ancient World*, above n 115 at 227.

last party in the chain. However, along the chain, any act of perfect execution by **Paymaster**, such as stipulation towards a delegatee, discharges **Paymaster** towards all prior delegators and discharges each prior delegator to his delegatee.<sup>271</sup> Conversely, along the chain, any act of imperfect execution releases neither **Paymaster** towards each delegator nor each delegator towards his delegate. Rather, in connection with the imperfect execution, it is performance by payment to the ultimate delegatee that discharges **Paymaster** and each delegator.

Similarly, credit can be circulated where the assignee-**Creditor** re-assigns to E, who may be **Creditor**'s own creditor, the debt owed by **Paymaster** to **Debtor**. In such a case, 'double assignment' of **Paymaster**'s debt to **Debtor** is involved; first by **Debtor** to **Creditor**, and second, by **Creditor** to E. In principle, E may further assign **Paymaster**'s debt to F, who may be E's creditor, and so on down an infinite chain. In each such case, **Paymaster** will ultimately pay the last party in the chain. However, in the early period, an assignee **Creditor** could re-assign to E the debt owed by **Paymaster** to the assignor **Debtor**, only as of the time control passed to **Creditor** of the claim against **Paymaster**, namely as of the joinder of issue (*litis contestatio*);<sup>272</sup> at that point the judge was directed to 'condemn' **Paymaster** to pay **Creditor** on the basis of the debt owed by **Paymaster** to **Debtor**, so that *novatio necessaria*, or novation by the operation of law, was said to occur. Dependence on *litis contestatio* ceased to exist at the time of Emperor Antoninus Pius (138–161 CE); yet in fact until Justinian the assignee's claim was precarious, and even thereafter has remained subject to the original debtor **Paymaster**'s defences against **Debtor**.<sup>273</sup>

The efficacy of both the re-delegation and the re-assignment (namely re-cession), is premised on the independent right of **Creditor**, acquired in the course of the execution of either the delegation or cession by **Debtor**. This independent right in **Creditor**'s hands can then be conferred by him, by means of re-delegation or re-cession, onto E. In connection with successive delegations or cessions, as in fact in connection with one delegation or cession, one payment, and possibly one undertaking to pay, made by **Paymaster**, discharges a multiplicity of debts. The 'circulation' of the delegatee's or cessionary's entitlement, through a series of delegations or cessions, was said to resemble that of the circulation in later days of cheques and bills of exchange by one or more endorsements; though the 'circulation' of C's entitlement did not involve the circulation of physical instruments, it had the similar positive effect of bringing about a reduction of payments in specie in addition to an enhancement in the circulation of credit.<sup>274</sup>

<sup>271</sup> For the impact of the perfect execution by novation and stipulation, see section 6.2 above.

<sup>272</sup> See Watson, above n 36 at 181–83.

<sup>273</sup> See text at nn 238–44 above.

<sup>274</sup> On this point, recognized in ch 10, section 4 below, see Roby, above n 2 at 43, and in greater detail, Maxwell, above n 2 at 106–08.

### 10.3 Payment to a Distant Party

A mechanism for carrying on payment between distant parties, dispensing with the need for the physical transfer of coins between the two cities, consists of the following steps:<sup>275</sup>

1. A debtor in Rome who wishes to effect a non-cash payment to his creditor in Carthage delivers coins in the sum of the payment to a banker in Rome who has a *dispensator*,<sup>276</sup> or correspondent in Carthage.<sup>277</sup>
2. The Roman debtor (**Debtor**) may advise the Roman banker (**Paymaster**) that payment of this sum is to be made to the creditor in Carthage (**Creditor**). Depending on whether the mechanism chosen is a delegation or cession, this advice may serve either as a delegation order or notice to the account-debtor in a *cessio* (by **Debtor** to **Paymaster**).<sup>278</sup> The debtor (**Debtor**) may further procure from the Roman banker (**Paymaster**) a stipulatory obligation to make the payment to the creditor in Carthage (**Creditor**). Not having been made with the Carthagenean creditor (**Creditor**), this stipulation binds the Roman banker (**Paymaster**) only towards the Roman debtor (**Debtor**), the counter-party to the stipulation, but not towards the Carthagenean creditor (**Creditor**).<sup>279</sup>
3. In the case of a delegation, the Roman banker, as a mandatary,<sup>280</sup> ought to appoint the Carthagenean banker as a substitute to act for him.<sup>281</sup> In compliance with the debtor's delegation order, the Roman banker may thus issue a delegation order of his own to his correspondent banker in Carthage.<sup>282</sup>

<sup>275</sup> The scenario set out below is from Platon, above n 88 at 108–09. In effect, the same analysis will apply where **Debtor** and **Creditor** are in the same city but use different bankers. Conversely, where **Debtor** and **Creditor** are in the same city and are clients of the same *argentarius*, legal analysis is substantially simpler. See section 4 above.

<sup>276</sup> Technically, the *dispensator* was a financial manager or cashier; cf Berger, above n 2 at 438.

<sup>277</sup> For inter-city bilateral correspondent relationships between bankers in the Roman world see eg Humbert, *Argentarii*, above n 30 at 407.

<sup>278</sup> Of course, *cessio* (though not *delegatio*) may operate even without notice, though subject to the drawbacks enumerated above in section 9.

<sup>279</sup> Presumably, this stipulation is required so as to bind the Roman banker to make payment in Carthage rather than in Rome.

<sup>280</sup> In fact, the need to encompass the delegation by the delegatee, as in such a case, lends further support to the conclusion that the delegator-delegatee relationship is that of a mandate, as concluded in section 3 above.

<sup>281</sup> The mandatary was regularly allowed to appoint a sub-mandatary. See Dannenbring, above n 2 at 230. Doubts which may exist in relation to the mandatary's power to appoint a substitute to act for him do not apply to the case where the mandatary was authorized to do so as in connection with payment to a distant party designed to dispense with the need of the physical transfer of coins between the two cities. For the mandatary's release by the performance of a sub-mandatary see in general Watson, above n 36 at 179–85. *Quaere* a question which does not seem to be addressed by Watson, *ibid.*, is as to the mandatary's remedy upon the deficient performance by a qualified substitute or sub-mandatary. In such a case, may the mandator recover from the mandatary? From the substitute or sub-mandatary?

<sup>282</sup> The Roman banker will not make a stipulation to the Carthagenean one for two reasons. First, the two bankers are in two cities and cannot be present at the same place. Second, as explained below (under step 5), the Carthagenean banker will obtain reimbursement from the Roman one as the mandatary of the latter and thus does not require a stipulatory obligation anyway.



Depending on the specific arrangement, the Carthagenean banker may either pay the creditor in Carthage, or undertake to pay him; this undertaking is to be in the form of stipulation or any other type of agreement for the execution of a delegation order which is binding on the Carthagenean banker towards the Carthagenean creditor.<sup>283</sup> Usually some time between the Roman banker's delegation order and either payment or undertaking by the Carthagenean banker, the Carthagenean creditor is to be advised.

4. Alternatively to step 3, in a case of a cession, the Roman debtor (**Debtor**) may assign to the creditor in Carthage (**Creditor**) the debt owed to the Roman debtor (**Debtor**) by the Roman banker (**Paymaster**); effectively, the Roman debtor may authorize the Carthagenean creditor to collect the sum held by the Roman banker, and keep the proceeds for himself. This is in fact '*mandatum ad agentum*' of the early period.<sup>284</sup> Upon receiving the authorization, the Carthagenean creditor appoints the Carthagenean banker, correspondent of the Roman banker, to collect the money from the Roman banker.<sup>285</sup> In acting under the authority given by the Carthagenean creditor, the banker in Carthage is acting under a true mandate; the Carthagenean banker executes this mandate by collecting the funds from the Roman creditor and making them available to the Carthagenean creditor.<sup>286</sup>
5. Regardless of whether it is step 3 (under a delegation) or 4 (under a cession) that is carried out, the Carthagenean banker typically has to pay the creditor in Carthage out of funds held or owed by the Carthagenean banker, as a dispensator for, effectively, under a mandate from, the Roman banker. Where he does not owe any amount to the Roman banker, the banker in Carthage is to recover from the Roman banker under whatever arrangement they have between them; possibly, the Roman banker may then pay the Carthagenean banker out of funds held or owed by the former to the latter. Other than when funds are held by one banker for the other, in which case an adjustment of the balance due is to be made for each payment, payment between the bankers is likely to be made periodically, for netted amounts, reflecting a continuous activity carried on between them for their customers in both directions. In any event, whatever procedure is effected, no stipulatory engagement can be undertaken by the Carthagenean banker to the Roman banker, as they are located in different places.

<sup>283</sup> As fully discussed in sections 6–7 above.

<sup>284</sup> See text at n 230 above.

<sup>285</sup> Presumably, however, in the early period, this could not be carried out before the *litis contestatio* stage, prior to which a *procurator ad litem* was not allowed to delegate. See text and n 273 above.

<sup>286</sup> Note however that payment by the Roman banker to the Carthagenean one, as a mandatary for the Carthagenean creditor, is payment by the Roman debtor to the Carthagenean creditor. For discharging an obligation other than by performance to which 'the debtor was bound to render to the creditor', but rather by means of 'something which the creditor was willing to accept in its place (*datio in solutum* – substituted performance)' see in general, Lee, above n 6 at 412–13. See also Berger, above n 2 at 425. In the case under discussion it is the creditor's mandatary who accepts the substituted performance on the creditor's behalf.

In the context of a payment between distant parties, a significant difference between the effect of a delegation and assignment is the time the Roman **Debtor** is discharged towards his Carthaganean **Creditor**. Thus, per step 3 above, in a delegation, **Debtor** will be discharged not earlier than at the time of the stipulatory obligation of the Carthaganean banker to **Creditor** in Carthage. At the same time, per step 4 above, in an assignment, **Debtor** will be discharged as soon as the assignment takes place, that is, upon the authorization given by him to **Creditor**.

#### 11. FINAL OBSERVATIONS: THE UNCERTAIN HERITAGE OF ROMAN LAW

Under Roman law, in the process of facilitating the discharge of **Debtor's** debt to **Creditor** by **Paymaster**, **Creditor** may have acquired rights against **Paymaster** either as a delegatee or cessionary/assignee.

Thus, the acceptance by **Paymaster** of **Debtor's** order delegating to him a payment obligation to **Creditor**, is by means of an agreement between **Paymaster** and **Creditor**, which generates a new obligation by **Paymaster**. In the case of an absolute (pure) delegation, such a (typically) novated stipulated obligation by **Paymaster** to **Creditor** is neither subject to **Paymaster's** defences against **Debtor** nor to **Debtor's** defences against **Creditor** and is not supported by any collateral securing either **Paymaster's** obligation to **Debtor** or **Debtor's** obligation to **Creditor**. This state of law crystallized in the classical era; certainly however it was lost in the reform projects of Justinian.

In contrast, the cession (or assignment) to **Creditor**, of **Debtor's** rights against **Paymaster** on the basis of **Debtor's** authorization to **Creditor** to collect from **Paymaster**, does not generate a new obligation by **Paymaster**; nor does it require **Paymaster's** acceptance or consent. To that end, in the hands of **Creditor**, **Paymaster's** obligation remains subject to **Paymaster's** defences against **Debtor** as well as being supported by collateral securing that obligation. Recognition in Roman law of the full control of the assignee-**Creditor** over **Debtor's** right against **Paymaster** is rooted in the work of Justinian, but came to be fully recognized only in the nineteenth century. The effect of the cession (that is, assignment), generated by the authorization to collect on the debt owed by **Debtor** to **Creditor**, including the collateral securing it, is a matter of a separate agreement between **Debtor** and **Creditor**.

Historically, at the time of Justinian, the decline of delegation, resulting from the erosion in formalism in Roman law, coincided with the ascent of cession (namely assignment), resulting from the buttressing of **Creditor's** right as a cessionary (that is, assignee).<sup>287</sup> Compared to delegation, cession had the advantage of dispensing with **Paymaster's** acceptance, namely, engagement to **Creditor**. Yet, even from **Creditor's** perspective, this advantage is superficial;

<sup>287</sup> For the two processes, see sections 8 and 9 above. For the observation as whole, see eg Maxwell, above n 2 at 39 and 45.

cession has not given **Creditor** an independent and autonomous right free of defences,<sup>288</sup> and its effect on **Creditor**'s rights towards **Debtor** has not been all that obvious. Certainly, being independent and autonomous, the right conferred on **Creditor** towards **Paymaster** under a delegation is more 'liquid' than that under a cession. As well, any advantage cession may have had was of a short duration; between the time of Justinian and the nineteenth century, with the erosion of the recognition of **Creditor**'s independent right, cession itself declined.

Furthermore, an assignment, dispensing with **Paymaster**'s agreement or consent, is available only when there is a pre-existing debt owed by **Paymaster** to **Debtor**. Such is not the case, and hence assignment is not available, when **Paymaster**'s debt to **Debtor** is to be created only in the performance by **Paymaster** of **Debtor**'s obligation to **Creditor**. Such performance by **Paymaster** of **Debtor**'s obligation to **Creditor** is carried out by means of **Paymaster**'s payment or agreement to pay **Creditor**, namely, as a result of credit extension from **Paymaster** to **Debtor**. In such a case, **Paymaster**'s agreement is required for the mechanism to work, so that only delegation and not assignment will be available.

Between the two mechanisms, delegation is thus the more comprehensive one, as it may cover both cases, the one in which a pre-existing debt is owed by **Paymaster** to **Debtor** and the other in which it was not owed. Hence, arguably, delegation is the mechanism to be preferred. And yet, parties may be free to choose any mechanism available to them to achieve their goal; thus, when **Paymaster** owed money to **Debtor**, the possibility of an assignment ought not to be overlooked.

Nevertheless, the characterization of a given situation as either delegation or cession is not all that simple. This is so notwithstanding the fact that delegation and cession have distinct flows of communication. Thus, delegation consists of an order communicated by **Debtor** to **Paymaster** followed by the engagement of **Paymaster** communicated to **Creditor**. Conversely, the cession consists of a communication from **Debtor** to **Creditor**, followed by communication from **Creditor** to **Paymaster**. Stated otherwise, the delegation fits the payment order a payer (**Debtor**) issues directly to his bank; at the same time, the cession fits a payment order, such as the latterday cheque, issued by the payer (**Debtor**) to the payee (**Creditor**), who is to present it for payment to the payer's bank (**Paymaster**).

However, in an informal environment, that is, in the absence of formal standardized communication flow and with no required specific language, this clear-cut distinction is easily blurred. Thus, in a delegation, **Debtor** is likely to advise **Creditor**, and in a cession, there is nothing to preclude **Debtor** from advising

<sup>288</sup> As already noted in n 247 above, doctrines such as the holder in due course (for a promissory note) and waiver of defence clause (in a contract for sale) are relatively new – and never worked perfectly to isolate assignee **Creditor** from obligor **Paymaster**'s defences against **Debtor**. See B Geva, *Financing Consumer Sales and Product Defences in Canada and the United States* (Toronto: Carswell, 1984).

**Paymaster** (and hence arguably instructing him),<sup>289</sup> as well as **Paymaster** from advising **Creditor**. In what otherwise may have looked like a cession, particularly when **Paymaster** owes money to **Debtor**, and more so when **Paymaster** is a banker owing to **Debtor**, **Paymaster's** advice to **Creditor**, and possibly even **Paymaster's** silence following the advice he received from either **Debtor** or **Creditor**, may well be construed as an undertaking of **Paymaster** to **Creditor**; this could have turned the mechanism into a delegation. Flow of communication is particularly inconclusive in what is often referred to as a 'double mandate' case, in which **Debtor** instructs both **Paymaster** to pay, and **Creditor** to collect from **Paymaster** (without accounting for the proceeds). In such a case, it appears as though there is both a delegation order to **Paymaster** as well as a cession to **Creditor**.<sup>290</sup>

In the absence of formal requirements for each mechanism, and when the flow of communication gives mixed signals, classification in each case is to be determined by the intention of the parties. Unfortunately however, the intention of the participants in the transaction may not be easily discernible and as such is a poor indicator as to the nature of the mechanism. Whether a given situation involves either a delegation or an assignment; whether a delegation is perfect (novatory) or imperfect, absolute (pure), or qualified; and whether an assignment is outright, with or without recourse, or is by way of security, may thus involve a close judgement call. This is so due to the mixed results for, and conflicting interests of, each participant under each mechanism. Briefly stated, an absolute (or pure) delegation gives **Creditor** a defence-free claim but extinguishes securities;<sup>291</sup> an assignment preserves **Paymaster's** defences and securities.<sup>292</sup> Defences and securities are also preserved in a qualified delegation.<sup>293</sup> Finally, recourse may be available to **Creditor** against **Debtor** either in connection with the imperfect execution of delegation, namely, where no novation occurs,<sup>294</sup> or in connection with an assignment, either absolute with recourse, or by way of security.<sup>295</sup>

<sup>289</sup> Unless of course, **Debtor's** advice to **Paymaster** is viewed as a mere alert notice, as in the 'control notes' of Ptolemaic Egypt, discussed in ch 3, section 5, text around n 188 above, for which see eg R Bogaert, 'Note sur l'Emploi du Chèque dans l'Égypte Ptolémaïque' (1983) in *Trapezitica Aegyptiaca*, Recueil de Recherches sur la Banque en Égypte Gréco-Romaine (Firenze: Edizioni Gonelli, 1994) at 245. Obviously, however, determining the nature of the advice depends on the intention of the parties and the language used; in an informal environment, this is to be decided each time on a case-by-case basis.

<sup>290</sup> Reference (though not favourable) to such a term appears eg in Sorbier, above n 264 at 20, 26. Certainly, the 'mandate' to the assignee **Creditor** does not appear to be a true mandate since collection is for his benefit; this is so unless **Creditor** is viewed as collecting for the benefit of **Debtor**, and then retaining the proceeds for himself on the basis of 'compensation' between **Debtor's** debt to him and his obligation to account to **Debtor**. For compensation under Roman law see text at nn 61–71 above.

<sup>291</sup> As fully discussed in section 6.2 above.

<sup>292</sup> As fully discussed in section 9 above.

<sup>293</sup> As fully discussed in section 6.2 above.

<sup>294</sup> As fully discussed in section 5 above.

<sup>295</sup> As fully discussed in section 9 above.

Thus, **Debtor** typically wishes to have his discharge expedited; prompt discharge is accorded to **Debtor** both in connection with the perfect execution of delegation (upon **Paymaster's** novated obligation to **Creditor**) and in an outright assignment without recourse (upon the acceptance by **Creditor** of **Debtor's** assignment). Indeed, **Creditor's** agreement (in an assignment) is likely to precede **Paymaster's** acceptance (in a delegation). This however will not be advantageous to **Debtor** either when **Debtor** is assured of **Paymaster's** forthcoming acceptance or where **Debtor** is concerned that breach by **Creditor** may occur, in which case it is actually in **Debtor's** interest to retain the power to revoke the operation.<sup>296</sup> Revocation is possible until **Paymaster's** acceptance in a delegation (but not in an assignment). In many cases, **Debtor** may not be able to properly assess the situation, and may thus be neutral as to his preference between these two options.

For his part, **Creditor** may however be equivocal; on one hand, he may wish to obtain a liquid right against **Paymaster**, free of defences of both **Paymaster** towards **Debtor** and **Debtor** against **Creditor**, which would cause **Creditor** to prefer an absolute (or pure) delegation. On the other hand, unless **Paymaster** is a banker or is otherwise of unquestionable creditworthiness, **Creditor** may wish to have recourse against **Debtor** as well as against the securities provided by him. **Creditor** would get this in an outright assignment with recourse, in an assignment by way of security, or as a result of the execution of a delegation order given under the reservation of risk. At the same time, upon the perfect qualified execution of the delegation, **Creditor** will get neither a defence-free claim, nor a recourse right against **Debtor**. Nevertheless, depending on whether the qualified execution of the delegation was in the form of the assumption by **Paymaster** to **Creditor** of either **Debtor's** debt to **Creditor** (transfer of a debt or passive obligation) or of **Paymaster's** own debt to **Creditor** (transfer of a credit or active obligation), **Creditor** could also have the benefit of securities provided by either **Debtor** or **Paymaster**.

Finally, **Paymaster** may prefer not to become liable to **Creditor** without making a conscious decision to that effect,<sup>297</sup> which would make him desire a delegation; at the same time, **Paymaster** would rather not see his defences against **Debtor** forfeited when **Paymaster** becomes indebted to **Creditor**, which makes **Paymaster** prefer an assignment. To that end, upon the perfect qualified execution of the delegation, depending on whether the qualified execution of the delegation was in the form the assumption by **Paymaster** to **Creditor** of either

<sup>296</sup> In short, in case of defences available to **Debtor** against **Creditor**, **Debtor's** preference is to have payment to **Creditor** with held rather than subject to recovery. **Paymaster's** obligation to pay **Creditor** under a pure (or absolute) delegation is free of **Debtor's** defences to **Creditor**. See section 6.2 above.

<sup>297</sup> Strictly speaking, this is more as a matter of intuition on **Paymaster's** part rather than for any substantive reason since towards the assignee **Creditor**, **Paymaster's** obligation is exactly as it was towards original creditor (assignor) **Debtor**. And yet, inasmuch as under assignment **Creditor's** right against **Paymaster** depends on a notice to be given to **Paymaster**, compared to under delegation, there may be greater potential for ambiguity and uncertainty in an assignment.

**Debtor's** debt to **Creditor** (transfer of a debt or passive obligation) or of **Paymaster's** own debt to **Creditor** (transfer of a credit or active obligation), **Paymaster** would be able to assert against **Creditor** either **Debtor's** defences against **Creditor** or **Paymaster's** defences against **Debtor**. Alternatively, as a banker bound to execute **Debtor's** order, **Paymaster** may prefer to 'market' his undertaking as automatically binding towards **Creditor**, and yet free of defences available to **Paymaster** against **Debtor**; while it is assignment which makes **Paymaster** automatically bound to **Creditor**, it is the absolute delegation that would render **Paymaster's** obligation absolute.

Where **Debtor** and **Creditor** are located in different places, additional and potentially conflicting factors become present. In such a case, it is in the interest of each of the two parties to avoid the risk of loss in transit (including the risk of insolvency of **Paymaster**) and, rather, allocate it to the other party. From this perspective, **Debtor** would prefer to obtain his discharge upon his payment to **Paymaster** in **Debtor's** own place. For his part, **Creditor** would rather discharge **Debtor** in **Creditor's** own place. Thus, **Debtor** would prefer an assignment while **Creditor's** preference would be the delegation. On the other hand, **Debtor** may wish to delay his discharge by retaining control and power of revocation for as long as possible, while **Creditor** may wish to obtain payment, namely, not to be exposed to **Debtor's** revocation power, as early as possible. From this perspective, it is **Debtor** who would prefer a delegation while **Creditor's** preference would be for an assignment.

For his part, **Paymaster** would be neutral; from his perspective the issue is only whether he is responsible for the loss; in the case of an affirmative answer, it would usually not matter to him whether he is to be liable for the loss to **Debtor** or **Creditor**.

Regrettably, Roman law has arrested the development of formal written contracts subject to simplified execution procedures whose legal implications are predictable and certain.<sup>298</sup> No wonder then that Roman law passed on the opportunity to develop an instrument embracing both **Debtor's** order to pay and **Paymaster's** binding acceptance towards **Creditor**. In short, there are no traces in Roman law of a nascent bill of exchange. And yet, Roman law is not devoid of payment mechanisms or of discussions raising issues of liability on those mechanisms. Subsequent developments resolved those issues in the context of bills of exchange.

The Roman legal system was correctly described as 'one of the major intellectual achievements of the ancient world.'<sup>299</sup> And yet, in the final analysis, the heritage of the Romans to the legal history of the payment order is unclear. Undoubtedly, Roman law dealt extensively with relevant concepts and yet, it has not crystallized those concepts into definite and predictable structures. It laid down principal components but failed to assemble them into a cohesive frame-

<sup>298</sup> See discussion in sections 7.2 and 8 above.

<sup>299</sup> Terpstra, above n 266 at 344.

work. Certainty has been lost, particularly with the shift from formalism to an emphasis on the intention of parties, which is difficult to ascertain. An opportunity to create greater certainty was also lost with the failure to develop written, simplified and yet formal contracts. At the same time, available concepts remained useful, albeit subject to manipulation. In turn, it was precisely that 'manipulability' that preserved the concepts and made them available for use in due course. As will be seen in chapter eight below, it is the flexibility of concepts inherited from Roman law that may have facilitated the crystallization of the legal features of the bill of exchange. However, in the final analysis, having enriched the discussion, set out options, and provided building blocks for future development, Roman law on its own fell short of resolving underlying issues.



## The Medieval *Hawale*: The Legal Nature of the *Suftaj* and Other Islamic Payment Instruments

|                                                                                       |     |
|---------------------------------------------------------------------------------------|-----|
| 1. Introduction: Banking and Payment Institutions in the Medieval Islamic World       | 252 |
| 2. Transfer of Debt under Islamic Law: The <i>Hawale</i>                              | 257 |
| 2.1 The Mandate for Collection and the <i>Hawale</i> Concept                          | 257 |
| 2.2 The <i>Hawale</i> in Legal Doctrine                                               | 259 |
| 2.3 Codification of Hanafi Law: The <i>Hawale</i> under the Mejlle                    | 268 |
| 3. The <i>Suftaj</i> and Other Islamic Payment Instruments: The <i>Hawale</i> Applied | 277 |
| 3.1 Islamic Payment Instruments and the <i>Hawale</i> : An Overview                   | 277 |
| 3.2 The <i>Suftaj</i> under <i>Hawale</i> Principles                                  | 284 |
| 3.3 The Legal Nature and Operation of the <i>Suftaj</i>                               | 290 |
| 3.4 The Objections to the <i>Suftaj</i>                                               | 299 |
| 4. Conclusion: <i>Hawale</i> , <i>Suftaj</i> and the Bill of Exchange                 | 301 |

### 1. INTRODUCTION: BANKING AND PAYMENT INSTITUTIONS IN THE MEDIEVAL ISLAMIC WORLD

**B**Y THE MIDDLE of the eighth century CE the Arabs established their dominion from the Atlantic Ocean to the west of the Persian Gulf. In the process, they spread Islam and established Islamic law<sup>1</sup> as the law of the

<sup>1</sup> The Islamic legal system is traced by the classical theory to four sources: 'the Koran, the *sunna* of the Prophet, that is, his model behavior, the consensus of the orthodox community, and the method of analogy.' See J Schacht, *The Origins of Muhammadan Jurisprudence* (Oxford: Clarendon Press, 1950, reprint 1959) at 1. For the evolution of the Islamic legal system see in general eg NJ Coulson, *A History of Islamic Law* (Edinburgh: Edinburgh University Press, 1964). But for possible influence of local laws that existed in the newly acquired territories, see eg P Crone, *Roman, Provincial and Islamic Law* (Cambridge: Cambridge University Press, 1987) at 92–93 and App 2 at 102 where a view (attributed to Goldziher) on the strong influence of Roman law on Islamic jurisprudence is cited and documented. Byzantine influence is discussed by J Schacht, 'Droit Byzantin et Droit Musulman' in Accademia Nazionale dei Lincei, *Convegno di Scienze Morali Storiche e Filologiche: Oriente ed Occidente nel Medio Evo* (Roma: Accademia Nazionale dei Lincei, 1957) at 197.

land throughout this entire vast territory. Until the rise of the Turkish Ottoman Empire between the thirteenth and the sixteenth centuries CE, that territory included North Africa (both Egypt and the Maghreb), Israel/Palestine, Lebanon, Syria, Iraq and Arabia.<sup>2</sup>

The era of the pre-Ottoman Arab domination of those lands roughly coincides with the Middle Ages.<sup>3</sup> During that time, centres of economic and financial activity were located in the Near East in the land between the rivers Tigris and Euphrates as well as along the river Nile; respectively, those centres coincide with modern-day Iraq and Egypt.<sup>4</sup> It was observed that the business practices and instruments that had developed throughout those lands during that period heralded the bill of exchange, both as a mechanism for the transmission of funds and as a negotiable instrument.<sup>5</sup> These Islamic instruments,<sup>6</sup> the law that governs them, and the grounds of the aforesaid thesis are the focus of this chapter.

At first blush, identifying the Islamic lands as the ‘cradle of negotiability’<sup>7</sup> is counter-intuitive. As discussed in chapter eleven below, thriving banking builds on ‘negotiability’ as a lubricant facilitating liquidity. However, banking is premised on lending for profit out of bank deposits; in turn, deposit taking is bound to flourish where the deposit taker remunerates depositors, namely, pays interest on deposits. It is against the background of a growing banking system that one expects the development of any non-cash payment system<sup>8</sup> as well as instruments designed to support the necessary foundation for its operation. Islamic law prohibits the taking of interest on loans and thus does not provide adequate legal infrastructure for banking to develop. Not surprisingly,

<sup>2</sup> For a historic outline (including a map) visit [www.en.wikipedia.org/wiki/Islam#Rise\\_of\\_empire...28632.E2.80.93750.29](http://www.en.wikipedia.org/wiki/Islam#Rise_of_empire...28632.E2.80.93750.29). For Islamic law as the civil law of the Ottoman Empire, see the beginning of section 2.3 below.

<sup>3</sup> The Middle Ages are commonly dated from the fifth century fall of the Western Roman Empire until the fall of the Eastern Roman Empire in the fifteenth century. Visit [www.en.wikipedia.org/wiki/Middle\\_Ages](http://www.en.wikipedia.org/wiki/Middle_Ages).

<sup>4</sup> The former was the centre of the Abbasid Caliphate (between the middle of the eighth and the thirteenth century CE) while the latter was the centre of the Fatimid Caliphate (between the tenth and twelfth CE). See respectively [www.en.wikipedia.org/wiki/Abbasid](http://www.en.wikipedia.org/wiki/Abbasid) and [www.en.wikipedia.org/wiki/Fatimid](http://www.en.wikipedia.org/wiki/Fatimid).

<sup>5</sup> P Huvelin, ‘Travaux Récents sur l’Histoire de la Lettre de Change’ (1901), 15(1) *Annales de Droit Français, Étranger et International* 1, at 21–26, arguing at 25 that ‘the Arab influence is certain’ (hereafter: Huvelin, ‘Travaux’).

<sup>6</sup> Throughout this chapter, ‘instrument’ and ‘document’ are usually used interchangeably.

<sup>7</sup> The expression is mine; it purports to rephrase the observation indicated in the text and n 5 above. ‘Negotiability’ is used here to denote the sum of the features of a ‘negotiable instrument’; briefly stated, these are transferability by delivery so as possibly to give a complete title to the instruments and the rights therein. See text and n 127 below.

<sup>8</sup> For the link among these three activities, namely, deposit taking, lending and the provision of payment services as underlying the origin of banking in Ancient Greece, see R Bogaert, *Les Origines Antiques de la Banque de Dépôt* (Leyde: AW Sijthoff, 1966) at 137–44 (hereafter: Bogaert, *Les Origines*). At present, ‘To be recognized as a bank . . . an institution is expected to receive deposits of money from its customers; to maintain current accounts for them; to provide advances in the form of loans or overdrafts; and to manage payments on behalf of its customers’. See eg E Green, *Banking – An Illustrated History* (New York: Rizzoli, 1989) at 11.

in the Medieval Islamic world, 'banks' in the full sense of the word did not exist.<sup>9</sup>

And yet, the Medieval Islamic world had a monetary economy which nevertheless required banking services. Those came to be provided by private moneychangers, called *sarrafs*, and official moneychangers and assayers, called *jahbads*.<sup>10</sup> It is in the context of banking services provided by these actors that both new instruments and novel legal doctrine emerged.

Particularly noteworthy is the banking activity of the *jahbad*,<sup>11</sup> who was both a large merchant, as well as an expert in all monetary matters, and for whom the provision of banking services was thus an incidental business activity.<sup>12</sup> As a banker, a *jahbad* could act in a formal capacity for the State and royal court; to that end, he held a title which he kept for his lifetime and which was passable to his heirs. *Jahbads* tended to act in close networks that invoked trust so as to facilitate long-distance monetary transactions. Yet, *jahbads* stifled competition by precluding newcomers' entry to the profession.

Other than assaying, setting official rates of exchange for coins, and money changing, the banking activities of the *jahbads* were deposit taking, advancing funds to the authorities, and remitting funds. All three look like normal activities forming banking; yet, they bore significant variations from modern banking.

Thus, deposit taking was not carried out by way of borrowing from depositors and accumulation of funds to be lent. Rather, other than in conjunction with the remittance of funds as set out below, deposit taking was for safe keeping, pure and simple. Much of it was not even properly recorded as it was a means to hide wealth with trusted persons such as *jahbads*. There is however some controversy as to whether such deposits were profitably used by the *jahbad*,<sup>13</sup> and if so, it is not clear on what basis profit and loss were allocated. The supply of funds to public authorities was a major profitable activity of the *jahbad*; it was however carried out mainly not by regular lending but rather in

<sup>9</sup> AL Udovitch, 'Bankers without Banks: Commerce, Banking, and Society in the Islamic World of the Middle Ages' in Centre for Medieval and Renaissance Studies University of California, Los Angeles (ed), *The Dawn of Modern Banking* (New Haven and London: Yale University Press, 1979) at 255, 258–59 (hereafter: Udovitch, 'Bankers').

<sup>10</sup> For an overview, see eg SM Imamuddin, 'Bayt Al-Mal and Banks in the Medieval Muslim World' (1960), 34 *Islamic Culture* 22 at 27–30. For both categories as successors of the Byzantine *trapezitai* of Greco-Roman Egypt, see Bogaert, *Les Origines*, above n 8 at 163.

<sup>11</sup> For an extensive discussion, on which much of the ensuing paragraphs build, see WJ Fischel, *Jews in the Economic and Political Life of Medieval Islam* (London: Royal Asiatic Society for Great Britain and Ireland, 1937) at 2 (hereafter: Fischel, *Jews*). An earlier partial version of the relevant discussion is W Fischel, 'The Origins of Banking in Mediaeval Islam: A Contribution to the Economic History of the Jews of Baghdad in the Tenth Century' (1933) *The Journal of the Royal Asiatic Society* 339. See also CC Torrey, 'The Evolution of a Financier in the Ancient Near East' (1943), 2 *Journal of Near Eastern Studies* 295.

<sup>12</sup> It is in this sense that Udovitch, 'Bankers', above n 9 at 265–68 refers to the *jahbad*'s sphere of activity as 'merchant banking'.

<sup>13</sup> Thus, Fischel speculates that '[i]n all probability' amounts deposited with the *jahbads* 'were made productive'. Fischel, *Jews*, above n 11 at 26. Conversely, Udovitch, 'Bankers', above n 9 at 260, is of the view that deposits kept by a *jahbad* 'could not be used as a form of productive investment.'

conjunction with tax farming, that is, by way of making advance payments on account of future or deferred tax collections, of which a portion of revenue was kept by the *jahbad* as profit.<sup>14</sup>

Remittance of funds bore the closest resemblance to a normal banking activity. It was made both in the form of delivery of purses and non-cash payments. Delivery of purses containing specie or coins was a unique and unusual banking activity; it certainly indicates lack of developed banking services. Non-cash payments were both local and from place to place; their mechanisms and governing legal principles are the subject of the present chapter. At the outset I should however mention that while this activity gave rise to new types of documents, it did not seem to generate standard forms and procedures; certainly it did not give rise to interbank multilateral mechanisms for clearing and settlement. Moreover, in terms of scope, it may not have been significant in the context of the entire economy.<sup>15</sup> Indeed, the modest scope of the activity reflected the restricted nature of banking during that era. At the same time, the instruments the remittance of funds activity generated were novel, which required the legal framework that governed them to break new grounds; this activity thus heralded the bill of exchange, and enhanced the emergence of the negotiable instrument so as to constitute an important link in the legal history of the order to pay money. The significance of the remittance of funds activity in the Medieval Islamic era was more qualitative than quantitative.

Some form of deposit taking facilitating non-cash payments was practised in local markets by the *sarrafs*, the private moneychangers. Small retailers operating in those markets opened accounts with the *sarrafs*. The retailers deposited funds in those accounts on which they drew and made non-cash payments to their wholesalers.<sup>16</sup> In conjunction with such deposit accounts the *sarrafs* gave overdraft facilities to the retailers/account holders. Not having funds at hand, either in cash or in the form of credit to the account, the small retailers could thus nevertheless pay their suppliers by overdrawing the deposit accounts kept with the *sarrafs*. In compliance with the prohibition to charge interest, overdraft facilities were given by the *sarrafs* free of charge. The *sarrafs* profited from the

<sup>14</sup> Certainly, this profit must have been treated as a legitimate remuneration for his tax collection work rather than an illicit interest on the advances he made on the tax to be collected.

<sup>15</sup> Indeed, major works dedicated to the economic, financial and monetary system of the Medieval Near East do not mention the payment instruments, even in passing. See eg H Rabie, *The Financial System of Egypt: AH 564–741/AD 1169–1341* (London: Oxford University Press, 1972) and AS Ehrenkreutz, 'Monetary Aspects of Medieval Near Eastern Economic History' in MA Cook, *Studies in the Economic History of the Middle East from the rise of Islam to the present day* (Oxford: Oxford University Press, 1970, reprint 1978) at 37. To a similar effect in the period that preceded the Ottoman conquest, see D Ayalon, 'The System of Payment in Mamluk Military Society' (1958), 1 *Journal of Economic and Social History of the Orient* 37.

<sup>16</sup> See M Talbi, 'Opérations Bancaires en Ifriqiya à l'Époque d'al-Māzarī (453–536/1061–1141) – Crédit et Paiement par Chèque' in M Talbi, *Études d'Histoire Ifriqiyenne et de Civilisation Musulmane Médiévale* (Tunis: Publications de l'Université de Tunis, 1982) at 420. See also M Gill, *In the Kingdom of Ishmael* (Tel Aviv: Tel Aviv University, 1997) vol I: *Studies in Jewish History in Islamic Lands in the Early Middle Ages*, at 497 [in Hebrew] who speaks of the use of the deposit document to make payments to the suppliers.

scheme by taking advantage of the prevailing bi-metallic currency system; they thus credited in gold dinars deposits made by retailers to the accounts in silver dirhems, using for the conversion a lower exchange rate than the going one.<sup>17</sup> In honouring payment orders drawn on the accounts, the *sarrafs* thus provided chequing services to their account holders.<sup>18</sup>

Having set out briefly in this section the institutional framework, this chapter proceeds to discuss in section 2 the *hawale*, as the legal doctrine underlying the transfer of debts under the various schools of Islamic law. Subsequently, section 3 analyses the Medieval Islamic payment instruments, and their operation in the context of *hawale* principles. The discussion covers the *ruq'a* and *sakk*, which were particularly used for local payments, as well as the *suftaj*, which facilitated the remittance of funds in the form of non-cash payments from place to place. Section 4 concludes by assessing the role and place of these instruments and the legal framework in which they operated as forerunners for the bill of exchange as both a payment mechanism and negotiable instrument.

The major contribution of the present discussion is threefold. First, it contains an in-depth analysis of the *hawale* under the various Islamic schools of law. Among them, two major schools are the Hanafi and Maliki. The treatment of the *hawale* in the *Mejelle*, a nineteenth-century codification or restatement of Hanafi civil law, is also part of the analysis, designed to provide a measure of verification to the conclusions reached on the Hanafi rules. Second, the present discussion highlights the nature of the *hawale* as a legal doctrine covering the Islamic payment instruments. It does not treat the *hawale* as a 'financial technique' or type of a payment instrument, side-by-side with others. Stated otherwise, the discussion presents the view that it is inaccurate to speak of the *hawale* and *suftaj* as two types of financial techniques or instruments.<sup>19</sup> Rather, the former is the legal doctrine or set of rules covering the operation of the latter as a financial technique or payment instrument. Third, the discussion concludes by pointing at the Maliki rules of the *hawale* as having, in their treatment of Medieval Islamic payment instruments, a modest and yet distinct role in the overall evolution of negotiability. Ultimately, the *hawale* facilitated negotiability and engendered a major feature of the bill of exchange.

<sup>17</sup> Talbi, *ibid.*

<sup>18</sup> *Quaere* whether funds in each account were kept separately or whether they were mingled. Regardless, I could not find in Islamic legal doctrine anything similar to the Roman irregular deposit.

<sup>19</sup> As claimed by Udovitch, 'Bankers', above n 9 at 263. See further, n 120 below, and text around it.

## 2. TRANSFER OF DEBT UNDER ISLAMIC LAW: THE HAWALE

### 2.1 The Mandate for Collection and the *Hawale* Concept

In the footsteps of earlier legal systems,<sup>20</sup> Islamic law has not treated a debt or the claim to the money owed thereon as an item of property belonging to the creditor and hence disposable by him by transfer or otherwise.<sup>21</sup> However, over the years, bypassing strict orthodoxy, a few mechanisms have developed to confer on a debt the quality of a transferable item of property.<sup>22</sup>

The mandate for collection has played a principal role in that transformation. In this context, a creditor nominates the designated assignee,<sup>23</sup> typically his own creditor, as his 'mandatary', conferring on him the authority to collect a debt owed to the creditor by the creditor's own debtor. To achieve best results, the mandate to collect is to be reinforced by giving the mandatary-assignee the additional authority to sue a defaulting account debtor. The mandate is to be further strengthened by the inclusion therein of an express term under which the mandator waives the right of revocation. Vis-a-vis the mandatary-assignee, the mandator-creditor may also waive the benefit of the debt to be collected by renouncing his claim to proceeds to be collected.<sup>24</sup> Such a claim to the proceeds may anyway be lost to the mandator-assignor and accrue for the benefit of the mandatary-assignee to whom he owes by means of the operation of the right of setoff.<sup>25</sup>

Alternatively, a creditor may effectively waive his claim to a debt and confer it on a designated beneficiary, typically his own creditor, by 'acknowledging' that the debtor's debt is actually owed to that assignee.<sup>26</sup> Such an 'acknowledgement' bestows on the designated beneficiary the power to receive payment from the account debtor and give him a discharge. To allow the beneficiary to sue the

<sup>20</sup> For Roman law, see eg R Zimmermann, *The Law of Obligations-Roman Foundations of the Civilian Tradition* (Cape Town: Juta, 1990) at 58–59 and discussion in this book in ch 5, section 9 above. For Jewish law see S Albeck, 'The Assignment of Debt in the Talmud' (1957) 26 *Tarbiz* 262 [in Hebrew] and discussion in this book in ch 7, section 2.2 (particularly text at n 35) below.

<sup>21</sup> J Schacht, *An Introduction to Islamic Law* (Oxford: Clarendon Press, 1964, reprint 1998) at 134 (hereafter: Schacht, *Introduction*); and C Chehata, *Essai d'Une Théorie Générale de l'Obligation en Droit Musulman Hanéfite* (Paris: Editions sirey, 1936/1969) at 97.

<sup>22</sup> The following two paragraphs draw on E Tyan, 'Cession de Dette et Cession de Créance dans la Théorie et la Pratique du Droit Musulman (d'Après le Madhab Hanafite)' (1946), 2 *Annales de l'École Française de Droit de Beyrouth* no 3–4, 23 at 25–27 (hereafter: Tyan, 'Cession').

<sup>23</sup> Certainly, the mandatary, beneficiary of the transaction, is referred to here as an 'assignee' (and the transaction as an 'assignment') by reference to the practical implication of the arrangement, and not its formal legal characterization.

<sup>24</sup> See eg *Constantine Emilianides v Aristodemo Sophocli* (1910) 9 Cypr. L.R. 115, at 116, dealing (against the background of the Mejlle further discussed in section 2.3 below) with a creditor appointing an assignee as an agent for collection with authority to keep the proceeds.

<sup>25</sup> For the operation of setoff in general, see Chehata, above n 21 at 90–92.

<sup>26</sup> This is quite analogous to the Talmudic *Oditta* discussed in ch 7, section 2.2 below. See Zevin, SJ (ed), *Talmudic Encyclopedia* (Jerusalem: Yad Harav Herzog, 1955) [in Hebrew] vol 1 at 116.

creditor's debtor directly, the original creditor must however give him a specific power of attorney, which is treated as irrevocable.

Each such method could be used as a payment mechanism under which the creditor wishes to pay a debt he owes to the beneficiary-assignee by means of directing his own (creditor's) debtor, to be identified as the account debtor, to pay the beneficiary-assignee. In such a case, the creditor-assignor is the debtor in the payment mechanism, his own debtor (the account debtor) is the paymaster, and the beneficiary-assignee is the creditor. The efficacy of each such method has been premised on the power of a creditor [the debtor in the payment mechanism] effectively to confer on the beneficiary-assignee [the creditor in the payment mechanism] the right to the proceeds of a debt. The debt is owed to the creditor [the debtor in the payment mechanism] by the account debtor [the paymaster in the payment mechanism]; once its proceeds have been collected, they pass to the beneficiary-assignee [the creditor in the payment mechanism].

In theory however, it is neither the right to claim the debt, nor even to the money to be collected thereunder, that has been transferred. Rather, by means of his contract with the assignee [creditor], the automatic operation of setoff, or his own 'acknowledgement', the assignor [debtor] disabled or precluded himself from claiming the proceeds paid by the account debtor [paymaster] to the assignee [creditor]; the proceeds could thus be kept by the assignee [creditor] in satisfaction of the assignor [debtor]'s debt to him. Effectively however, each such method operates in the same way as an assignment to the beneficiary-assignee [the creditor in the payment mechanism] of the debt owed by the account debtor [paymaster] to the assignor [the debtor in the payment mechanism]; it thus does not require the consent of the account debtor [paymaster].

Beside such methods, Islamic law developed the *hawale* as a mechanism under which a debtor was able to transfer or shift his own obligation to pay his debt to another person. Thus, under Islamic law, the obligation to pay money owed, namely the indebtedness, has been considered as conferring a quality attached to, or bestowed on, the person of the debtor. Under specified conditions, it is however within the debtor's power to pass on this quality to another person, who is to replace him and become a new debtor to the creditor.<sup>27</sup> The one who becomes a new debtor under the *hawale* may already have been a debtor to another creditor; for him, namely, the one becoming a new debtor, the mechanism brings a new creditor. For example, having owed the debtor, the account debtor/paymaster becomes the transferee of the debtor; he replaces the transferor/debtor as the new debtor to the debtor's creditor. To that end, as explained below, stretching but staying within limits prescribed by Islamic doctrine, the *hawale* has developed to effect not only a change of a debtor to a creditor; rather it also developed to effect a change of a creditor to a debtor.

<sup>27</sup> A point highlighted by Tyan, 'Cession', above n 22 at 24.



## 2.2 The *Hawale* in Legal Doctrine

*Hawale* literally means ‘removal’<sup>28</sup> or ‘turn’. It denotes the transference of an obligation from one person to another, constituted by ‘an agreement by which a debtor is freed from a debt by another becoming responsible for it.’<sup>29</sup> What is transferred from the debtor to another person is an obligation to pay the debt; the *hawale* is thus distinguishable from the cession, which is the transfer from the creditor to another person of the right to the money owed or payment due on a debt.<sup>30</sup> Strictly speaking, to avoid a terminological confusion, it may thus be better to speak of the *hawale* as covering the transference of an obligation rather than of a debt; the latter is ambiguous and may be taken to mean relating either to the obligation to pay the debt or to the entitlement to the money owed on the debt.

In a *hawale* facilitating a payment mechanism, it is the paymaster (‘transferee’) who substitutes the debtor (‘transferor’), and takes over the debt owed by the latter to the creditor. In a practical setting, a paymaster-transferee who owes money to the original debtor-transferor expects not only that his payment to the creditor will confer a discharge on the original debtor-transferor towards the creditor; rather, he also expects that in the process he (the paymaster-transferee) will obtain his own discharge towards the original debtor-transferor. A paymaster-transferee who does not owe money to the original debtor-transferor intends either to extend credit to him or to give him a discharge from the creditor by way of gift.

As a matter of Islamic doctrine, the *hawale* is founded on the Prophet’s injunction regarding a creditor’s assent and claim against a solvent person to whom the original debtor transferred the debt. The injunction itself is however vague and open-ended.<sup>31</sup> Its full implications are explored by the four principal

<sup>28</sup> This is the preferred word used by C Hamilton, *The Hedya or Guide: Commentary on the Mussulman Laws*, trans by order of the Governor-General and Council of Bengal, 2nd edn (with preface and index by SG Grady) (Lahore: New Book House, 1957) at 330. ‘The Hedya or “guide” . . . consists of extracts from the most approved works of the early writers of Mohammadan Law, and was composed in the later half of the 12th century.’ See *Louka v Nichola* (1901) 5 Cyp LR 82 at 86, quoted by CA Hooper, *The Civil Law of Palestine and Trans-Jordan* (Jerusalem, Azriel Press, 1936) vol II at 24.

<sup>29</sup> For this definition see HAR Gibb and JH Kramers, *Shorter Encyclopaedia of Islam* (Leiden: EJ Brill; London: Luzac, 1953) at 137 where it is further stated that the transference of the obligation ‘is the angle around which this legal mechanism “turns”.’ The word further denotes the document by which the transference of the obligation is completed. *Ibid.* Particularly for other meanings, see also B Lewis, VL Ménage, C Pellat and J Schacht, *The Encyclopaedia of Islam* (Leiden: EJ Brill; London: Luzac, 1971) New Edition vol III at 283–85.

<sup>30</sup> For *cessio* in Roman law, see A Berger, *Encyclopedic Dictionary of Roman Law* (Philadelphia: American Philosophical Society, 1953) at 387. For a comprehensive discussion, see in this book, ch 5, section 9 above.

<sup>31</sup> Even translations are inconclusive if not altogether confusing. Thus, *The Hedya*, above n 28 at 332 quotes the Prophet as saying that ‘Whenever a person transfers his debt upon a rich man, and the creditor assents to the same, then let the claim be made upon the rich man.’ At the same time, according to the French translation and interpretation offered by Chéron and Fahmy Bey, in this saying, the Prophet is to be understood to command the creditor to accept the new solvent debtor

Islamic legal traditions which are the Hanafi, Maliki, Shafi'i, and Hanbali schools of law.<sup>32</sup>

Among these schools of law there is a disagreement<sup>33</sup> as to the legal theory underlying the *hawale*. Hence, some of its consequences are subject to controversies which bear practical implications.<sup>34</sup> Disputed matters relate both to the creation and the range of consequences of the *hawale*. Particularly, there is no consensus as to the identity of the parties to the agreement establishing the *hawale*; and while it is clearly stated that as a result of the *hawale* the paymaster-transferee becomes liable to the creditor to pay the amount due to the creditor by the original debtor-transferor, it is not immediately clear whether the original debtor is thereby automatically discharged altogether towards the creditor. Furthermore, it is not all that obvious whether the paymaster-transferee's liability to the creditor, resulting from the *hawale*, is on his own obligation to the original debtor-transferor (where such obligation exists), or whether it is on the obligation owed by the original debtor-transferor to the creditor.

offered to him. See A Chéron and MS Fahmy Bey, 'Le Transport de Dette dans les Législations Européennes et en Droit Musulman' I<sup>ie</sup> Partie, 'Le Transport de Dette (*Hewala*) en Droit Musulman' (1931), 22 *L'Égypte Contemporaine* 137 at 139, 148–49.

<sup>32</sup> These schools are discussed by Schacht, *Introduction*, above n 21 at 57–68. See also Coulson, above n 1 at 86–102. For a succinct account see Hooper, above n 28 vol II at 14–16. All such schools originated mostly in the course of the second century of Islam. Among them, the Hanafi school has been prominent in the east, particularly in Iraq and Syria, while the Maliki school has been prominent in the west, particularly in Egypt and North Africa. See Schacht, *ibid* at 65. The two original schools were the Hanafi and Maliki; the founder of the Shafi'i school was a pupil of the founder of the Maliki school, while the founder of the Hanbali school was a pupil of the founder of the Shafi'i school. The Maliki school makes heavy use of the prophetic *hadiths* (sayings of the Prophet). The Shafi'i school purports to be a synthesis of the Hanafi and Maliki systems but with greater stress on analogy. The Hanbali school is the strictest among all schools; it rejects analogy, consensus and judicial opinion as sources. For an overview, visit [www.fordham.edu/halsall/med/goldschmidt.html](http://www.fordham.edu/halsall/med/goldschmidt.html) and see the following four articles: [www.en.wikipedia.org/wiki/Hanafi](http://www.en.wikipedia.org/wiki/Hanafi), [www.en.wikipedia.org/wiki/Maliki](http://www.en.wikipedia.org/wiki/Maliki), [www.en.wikipedia.org/wiki/Shafi%60i](http://www.en.wikipedia.org/wiki/Shafi%60i), and [www.en.wikipedia.org/wiki/Hanbali](http://www.en.wikipedia.org/wiki/Hanbali). For the origins of Islamic jurisprudence prior to the emergence of these schools, see H Motzki, *The Origins of Islamic Jurisprudence: Meccan Fiqh before the Classical Schools*, trans by MH Katz (Leiden-Boston-Köln: Brill, 2002).

<sup>33</sup> Disagreement is not only among the various schools but on various points also internal to each of them. The ensuing discussion will focus on the salient lines of disagreement among the dominant theories of the four schools.

<sup>34</sup> The ensuing discussion largely draws on and develops the work of ND Ray, 'The Medieval Islamic System of Credit and Banking: Legal and Historical Considerations' (1997), 12 *Arab Law Quarterly* 43, 60–65. For a comprehensive discussion, equally relied on in the analysis that follows, see article by Chéron and Fahmy Bey, above n 31. The latter but not the former work covers also the Mejelle (discussed below in section 2.3). See also Chehata, above n 21 at 99–102; LWC van den Berg, *Principes du Droit Musulman Selon les Rites d'Abou Hanîfah et de Châfi'î*, trans by R de France de Tersant (Alger: Typographie Adolphe Jourdan 1896) at 100–01. Translated primary sources relied on are *The Hedya*, above n 28 at 332–34; Khalil ben Ish'âq, *Abrégé de la Loi Musulmane Selon le Rite de l'Imâm Mâlek*, vol III: Le patrimoine, trans by GH Bousquet (Alger: La Maison des Livres, 1961) at 69; Imam Malik ibn Anas, *Al-Muwatta' of Imam Malik ibn Anas: The First Formulation of Islamic Law*, trans by A Abdurrahman Bewley (London and New York: Kegan Paul International, 1989) at 309 (§36.31); GH Bousquet (annotated French translation), *Kitâb et-Tanbîh ou Le livre de l'admonition touchant la loi musulmane selon le rite de l'Imâm Ech-Châfê'î* vol II opérations sur patrimoine (Alger: La Maison des Livres, 1951) at 34–35 (hereafter: Bousquet, *Kitâb*); and H Laoust, *Le Précis de Droit d'Ibn Qudâma* (Beyrouth: Institut Français de Damas, 1950) at 104.

Certainly however, it is not an 'abstract' new obligation to pay the creditor the sum owed to him; that is, the paymaster's obligation is not divorced from the transaction that gave rise either to the debt originally owed by the paymaster-transferee (to the original debtor-transferor) or to the debt originally owed to the creditor (by the original debtor-transferor).<sup>35</sup>

Specifically disputed are the answers to the following five questions:

1. Who are the parties to the agreement under which a binding *hawale* is established?
2. Must the transferee (paymaster), who is to assume vis-a-vis the creditor the debt owed by the transferor (original debtor), have been indebted to the transferor (original debtor)?
3. Is recourse against the transferor (original debtor) available to the creditor upon the default of the transferee (the paymaster, namely, the new or replacing debtor)?
4. What defences are available to the *hawale* transferee (the paymaster) sued by the creditor?
5. What securities are available to the creditor enforcing his claim against the paymaster-transferee?

The principal dividing line is between the Hanafi school and all three others. Thus, in Hanafi law, the *hawale* is classified as a contract of surety or guarantee, under which the security of the transferee (paymaster)'s obligation is conferred on the creditor owed by the transferor (the original debtor).<sup>36</sup> Conversely, the other three schools classify the *hawale* primarily<sup>37</sup> as a sale or exchange in which, from the creditor's point of view, one debt extinguishes and is replaced by another.

This distinction underlies most differences in the answer to the abovementioned questions:<sup>38</sup>

*1. Who are the parties to the hawale agreement?*

- According to Hanafi law, the *hawale* is established by the agreement of the creditor and transferee (paymaster). Indeed, since 'mankind [is] of different dispositions with respect to the payment of debts,' the creditor must consent to the replacement of his debtor. The consent of the paymaster-transferee is also required 'because by the contract of the transfer an obligation of debt is imposed upon him.'<sup>39</sup> At the same time, neither the agreement nor the consent

<sup>35</sup> A point indicated by van den Berg, *ibid* at 101.

<sup>36</sup> *The Hedya*, above n 28 at 332.

<sup>37</sup> One important qualification is the formal adherence of the Hanbali school to the Hanafi guarantee view (see Chéron and Fahmy Bey, above n 31 at 140) and yet in line with the two other schools, to all the practical implications of the sale or exchange theory.

<sup>38</sup> Granted, though, that some solutions are pragmatic and vary from school to school, not according to any prevailing underlying philosophy.

<sup>39</sup> *The Hedya*, above n 28 at 332.

of the transferor (original debtor) is required. His agreement or consent is dispensed with since the paymaster-transferee's engagement is perceived as being made exclusively for the benefit of the original debtor-transferor so that it in no way adversely affects him.<sup>40</sup> Nonetheless, a paymaster may not have recourse against a debtor who has not consented to the *hawale*.<sup>41</sup> Thus, there is nothing to preclude the *hawale* from being instigated by the debtor's order to the paymaster-transferee; the latter will act then to implement the order by reaching an agreement with the creditor. It is this agreement which gives rise to the *hawale*. Regardless of whether the *hawale* is prompted by the original debtor-transferor's order, the agreement between the paymaster and the creditor may set limits on the paymaster-transferee's liability to the creditor. Such limits may be linked to the amount due from the paymaster-transferee to the original debtor-transferor (where there is such an amount due) or the existence of a fund.

- Conversely, under the three other schools, the *hawale* is a matter to be established by the agreement of the creditor with the original debtor-transferor; neither the agreement nor the consent of the transferee-paymaster is required. The latter is dispensed with inasmuch as the transferee-paymaster is, in any case, a debtor to the transferor-debtor. Since under these three schools the *hawale* is conceptualized as the exchange in the creditor's hands of one existing debt (owed by the debtor to the creditor) by another debt (owed by the paymaster to the debtor), its operation does not adversely affect the paymaster who remains charged with his original liability, though to a different person.
- Furthermore, in that regard, Hanbali law goes even further than Maliki and Shaf'i schools, in dispensing altogether with the creditor's consent as a formal requirement for the establishment of a *hawale*, as long as the transferee-paymaster, who is to replace the original debtor, is solvent. Hanbali law thus effectively transforms the *hawale* to a unilateral act of the transferor-original debtor.

## 2. *Is the transferee (paymaster) to be indebted to the transferor (original debtor)?*

- According to the Hanafi school, there is no requirement for a pre-existing debt owed by the paymaster-transferee to the original debtor-transferor; being a voluntary undertaking by him, the paymaster-transferee may incur liability on a *hawale* as he wishes, whether or not he is indebted to the transferor-original debtor.<sup>42</sup>

<sup>40</sup> *Ibid.* And yet, this prevailing view in Hanafite law is not without dissent. See eg I al-Ḥalabī (d. 956/ca. 1578), *Maṭn mulṭaqā 'l-abḥur* (Misr (Egypt): Muḥammad 'Alī Ṣabīḥ, ca. 1960) [in Arabic] at 160–61 (of which pages I had the benefit of unofficial translation) who requires the debtor's consent to be added to the paymaster-creditor agreement.

<sup>41</sup> Compared to Chéron and Fahmy Bey, above n 31 at 147–48 (as further discussed in text and n 76 below), Chehata, above n 21 at 100 is more definite on this point.

<sup>42</sup> In fact, the Hanafi school rationalizes the *hawale* not only on the Prophet's injunction, referred to around n 31 above, but also upon the voluntary undertaking of the paymaster-transferee. See *The Hedya*, above n 28 at 332.

- Conversely, all other schools envisage the paymaster-transferee's liability being incurred by means of a *hawale* irrespective of his volition; as indicated, this is reasonable only as long as he has anyway been liable for the money owed, albeit to another person, namely, the original debtor-transferor.
- Some flexibility exists, however, in Hanbali law, which facilitates the *hawale* even in the absence of a debt owed by the paymaster-transferee to the original debtor-transferor. In such a case the *hawale* is construed as a contract of agency under which the paymaster-transferee is authorized by the creditor to disburse a loan to the original debtor-transferor. Acting on this authority, the paymaster-transferee extends this loan to the original debtor-transferor by voluntarily (either paying or) incurring liability to the creditor, in discharge of the original's debtor liability to the creditor. Thereby the creditor becomes entitled to payment from the paymaster-transferee, to whom in turn, the debtor-transferor becomes liable on the loan.
- An attempted *hawale* by a paymaster-transferee who does not owe the transferor is treated by the adherents of the Maliki school as an undertaking to pay the debt of another (namely, that of the original debtor). Such a paymaster's undertaking constitutes an 'indemnity' contract.<sup>43</sup>

3. *Is recourse available to the creditor against the transferor (original debtor)?*

- The general rule in Islamic law is that a suretyship does not discharge the liability of the principal debtor to the guaranteed debt.<sup>44</sup> Being conceptualized by Hanafi law as the paymaster-transferee's guarantee, the *hawale* ought to have accommodated a continuous original debtor-transferor's liability to the creditor.<sup>45</sup> Ultimately, however, the notion that prevailed in Hanafi law is that, on the basis of the *hawale*'s effect to 'remove' or transfer the debt from the original debtor-transferor to the paymaster-transferee, the original debtor-transferor is to be discharged altogether, other than when collection from the paymaster-transferee becomes impossible.<sup>46</sup> Thus, the original debtor-transferor is taken to remain liable, though only contingently and in a quite

<sup>43</sup> Talbi, above n 16 at 433 does not use the term 'indemnity' (or any equivalent in French) and refers to such a contract as *hamāla*. However, according to Foster, the *hamala*, which is a synonym of *kafla*, is an ordinary guarantee, so that the indemnity contract which 'should not be confused with the *hamala*' is the *haml*. See NHD Foster, 'The Islamic Law of Guarantees' (2001), 16 *Arab Law Quarterly* 133 at 152. The indemnity contract is further discussed in connection with the ensuing points.

<sup>44</sup> See eg Schacht, *Introduction*, above n 21 at 158–59. This is so at least as long as the guarantee was given at the request of the principal debtor.

<sup>45</sup> According to this logic, it is the paymaster-transferee's liability which should have been secondary, or contingent upon the original debtor-transferor's (primary debtor's) default. But see eg van den Berg, above n 34 at 101 who speaks of the effect of the *hawale* under Hanafi law to confer a conditional discharge upon the original debtor, pending a default by the paymaster-transferee (which is obviously the reverse of an ordinary suretyship or guarantee).

<sup>46</sup> For this conceptualization of the creditor's recourse against the original debtor-transferor see E Tyan, 'Le Transport de Dettes en Droit Ottoman' (1925), 1 *Gazette des Tribunaux Libano-Syriens*, no 2, 25 at 29 (hereafter: Tyan, 'Transport').

limited way, in circumstances described as involving ‘the destruction of the debt’ owed by the paymaster-transferee to the creditor. Thus, in Hanafi law, once a *hawale* has been made, the original debtor-transferor becomes liable to the creditor upon the paymaster-transferee’s death in poverty, as well as when the paymaster-transferee denies the *hawale* which nevertheless cannot be proven by the creditor. This contingent liability is rationalized as analogous to the implied warranty of a seller of goods as to their quality.<sup>47</sup>

- At the same time, consistently with their treatment of the *hawale* as a transfer or sale of a debt, upon the paymaster-transferee’s default, all other schools deny the creditor recourse against the original debtor-transferor. Yet, other than under the Shafi’i school, this principle is subject to exceptions.
- Thus, in Maliki law, recourse against the original debtor-transferor is available to the creditor under prescribed narrow circumstances. First, recourse is available against the original debtor-transferor when he is guilty of misrepresentation. Second, recourse is available against the original debtor-transferor where the paymaster-transferee is shown to have been insolvent already at the time of the *hawale*.<sup>48</sup> In fact, these are apparent and not real exceptions; continuous debtor-transferor’s liability under Maliki law is more for misrepresentation and breach of warranty relating to the paymaster-transferee’s obligation and solvency than under a pure recourse for non-payment by the paymaster-transferee.<sup>49</sup>
- Hanbali law further restricts the creditor’s recourse against the original debtor-transferor to a case of paymaster’s insolvency, but only in circumstances of an obvious error, as well as where the debtor either expressly warranted the paymaster’s solvency or deceived the creditor in that respect.
- In general, all four schools allow creditor’s recourse against the debtor when the requirements for effecting a valid *hawale* have not been satisfied. An unresolved question in the Hanafi, Maliki and Shafi’i schools is the effect of an express stipulation<sup>50</sup> by the creditor as to either availability of recourse

<sup>47</sup> For this summary and the quotation see *The Hedya*, above n 28 at 332–33. See also Chéron and Fahmy Bey, above n 31 at 140 and 162–67 (further elaborating on the controversies and their resolution over the centuries), and Tyan, *Transport*, *ibid* at 28–29. According to *The Hedya*, *ibid*, the paymaster-transferee’s insolvency (or poverty) prior to death may be temporary and thus does not destroy the paymaster-transferee’s debt owed to the creditor so as to revive the original debtor-transferor’s liability. But cf Tyan, *ibid* who (in connection with the nineteenth-century Ottoman codification of Hanafi law discussed further below in section 2.3) nevertheless also notes the adjudication of the paymaster-transferee’s bankruptcy as an event that revives the original debtor-transferor’s liability. Certainly, bankruptcy adjudication and the ensuing bankruptcy discharge did not exist in Medieval Islam (or elsewhere during that time).

<sup>48</sup> According to Khalil ben Ish’âq, above n 34 at 69 this is so only where the original debtor-transferor was aware of the paymaster-transferee’s insolvency.

<sup>49</sup> Another apparent exception under Maliki law is where a person voluntarily assumes a debt of another, in which case, upon his death or insolvency, recourse is available to the creditor against the original debtor. Malik ibn Anas, above n 34 at 309 (§36.31). Per Maliki doctrine this is not, however, a case of *hawale*, which is established by the agreement of the original debtor and creditor, and does not involve the voluntary undertaking of the paymaster.

<sup>50</sup> Throughout this chapter, ‘stipulation’ is used in the modern sense of the word, denoting a contractual term or undertaking. Islamic law does not have a category of a unilateral, formal, ver-

against, or continued liability of, the original debtor, whether in general, or under specified circumstances.<sup>51</sup>

- As discussed, an attempted *hawale* by a paymaster-transferee who does not owe the transferor is treated in Maliki law as an undertaking to pay the debt of another (namely, that of the original debtor). Such paymaster's undertaking constitutes an 'indemnity' contract.<sup>52</sup> An indemnity contract is created by express words of the indemnifier and is treated as an undertaking by him to substitute the original debtor who is thereby released. No recourse against the original debtor is thus available to the creditor who accepted the indemnity. This is however only as long as the indemnity contract was pronounced between the indemnifier (that is, the paymaster-transferee) and the creditor in clear and unambiguous language; otherwise, as where the creditor is not aware of the fact that he is paid out of an overdrawn account of the debtor,<sup>53</sup> the latter remains bound on his original debt to the creditor.<sup>54</sup>

#### 4. What are the transferee (paymaster)'s defences?

- Under Hanafi law the paymaster-transferee becomes liable to the creditor on the original debtor-transferor's engagement; he ought thus to be able to raise defences available to the original debtor-transferor against the creditor.<sup>55</sup> In principle, however, as against the creditor, the paymaster may not be able to raise his own defences arising from his relationship with the original debtor-transferor, at least insofar as the *hawale* was not stated to be conditional on the original debtor-transferor's entitlement from the paymaster-transferee.<sup>56</sup>
- Conversely, according to all other schools, the paymaster remains liable on his original liability, which is redirected from the original debtor-transferor to the creditor; it thus appears that defences available to the paymaster on his original liability to the original debtor-transferor are neither extinguished nor

bal, and *stricti juris* contract, such as the *stipulatio* under Roman law, whose formation requires a question to be asked by the stipulant, a would-be promisee-creditor, immediately followed by an affirmative answer given by the person to whom the question was directed, who thereby becomes the promisor-debtor. Berger, above n 30 at 716. See in this book ch 5, section 6 above.

<sup>51</sup> Chéron and Fahmy Bey, above n 31 discuss this issue at 170–72 for all three schools but do not mention it in connection with Hanabali law. On the basis of the restrictive view of the Hanabali school on the availability of recourse (as in fact pointed out by these authors, *ibid* at 171–72), one may speculate that this school does not treat such stipulation as effective. According to van den Berg, above n 34 at 101, in Shafi'i law, recourse cannot be made available even by contract; Chéron and Fahmy Bey, *ibid* at 172 acknowledge this to be the dominant view of the Shafi'i school but cite a Shafi'ite opinion according to which this is an effective stipulation as long as it is stated to be a condition essential to the creditor's consent.

<sup>52</sup> See text and n 43 above.

<sup>53</sup> *Ibid.*

<sup>54</sup> Talbi, above n 16 at 433 and Foster, above n 43 at 152–53.

<sup>55</sup> This is also the view of Chéron and Fahmy Bey, above n 31 at 174–75. See text and n 83 below. But see the statement to the contrary (unaccompanied by analysis) by Chehata, above n 21 at 101.

<sup>56</sup> Which is the case of a restricted *hawale* defined in Art 678 of the Mejlle, and discussed in text around n 90 below.



substituted by those of the original debtor-transferor vis-a-vis the creditor. Rather, they remain fully available to the paymaster against the creditor. Certainly, the paymaster-transferee may not meet the creditor's action by raising the original debtor-transferor's defences against the creditor.

- Under the Shafi'i school, the picture is however not as straightforward. Indeed, defences available to the original debtor-transferor against the creditor may not be relied upon by the paymaster-transferee. This is so at least as long as these defences have been discovered after payment; an effective rescission of the obligation owed by the original debtor-transferor to the creditor, occurring prior to payment to the creditor by the paymaster-transferee, is seen by some as a basis for invalidating the *hawale*, namely for disentitling the creditor to claim from the paymaster-transferee. Furthermore, the paymaster-transferee may not assert against the creditor defences available to him against the original debtor-transferor, other than when the transaction between them, namely, between the paymaster-transferee and the original debtor-transferor, is void.<sup>57</sup>
- Regardless, so far as I can tell, no law has developed as to the availability to the paymaster-transferee against the creditor of defences that arise after the paymaster-transferee becomes liable to the creditor. Such defences may exist on the obligation on which the paymaster-transferee is now liable to the creditor, whether it is that of the original debtor-transferor to the creditor (under Hanafi law), or of the paymaster-transferee to the original debtor-transferor (according to the other schools). Alternatively, such defences may arise from any other matter in that bilateral relationship, namely either that of original debtor and creditor, or that of paymaster and the original debtor.
- As discussed, an attempted *hawale* by a paymaster-transferee who does not owe the transferor is treated in Maliki law as an undertaking to pay the debt of another (namely, that of the original debtor); such paymaster's undertaking constitutes an 'indemnity' contract. An indemnity is conceptualized in Islamic law as an undertaking to discharge another party's obligation;<sup>58</sup> prima facie, then, defences available to the debtor against the creditor may be asserted against the creditor by the indemnifier-transferee/paymaster.

##### 5. *What securities are available to the creditor?*

- Under Hanafi law the paymaster-transferee becomes liable to the creditor on the original debtor-transferor's engagement; logically it follows that both personal and proprietary securities supporting the original debtor's obligation remain intact. At the same time, a personal security in the form of a guarantee is given to secure the liability of a party trusted by the guarantor; in our case this party is the original debtor-transferor. At least in the absence of

<sup>57</sup> Bousquet, *Kitâb*, above n 34 at 34–35.

<sup>58</sup> See text and n 43 above.

recourse against the original debtor-transferor, it is unfair to force the guarantor to stand behind the obligation of another, in our case, the paymaster-transferee. For this pragmatic reason Hanafi law releases guarantors. Availability of proprietary securities remains contested.<sup>59</sup>

- Conversely, according to all other schools, the paymaster remains liable on his original liability, which is redirected from the original debtor-transferor to the creditor; it would thus appear that securities given to support his obligation, whether in the form of personal guarantees or property, remain fully effective.
- As discussed, an attempted *hawale* by a paymaster-transferee who does not owe the transferor is treated by the adherents of the Maliki school as an undertaking to pay the debt of another (namely, that of the original debtor); such paymaster's undertaking constitutes an 'indemnity' contract. An indemnity is conceptualized in Islamic law as an undertaking to discharge another party's obligation;<sup>60</sup> prima facie, then, availability to the paymaster of securities supporting the debtor's obligation to the creditor is governed by the same rules applicable to the availability of such securities to the paymaster in a *hawale* governed by Hanafi law.<sup>61</sup>

In the final analysis, the approaches of the two principal schools, the Hanafi and Maliki, can be summarized as follows:

1. Under Hanafi law, the parties to the *hawale* agreement are the paymaster and creditor; under Maliki rules they are the debtor and creditor.
2. The paymaster must have owed the debtor under Maliki law but not necessarily according to the Hanafi school.
3. In the case of default by the paymaster, both schools usually do not permit recourse by the creditor against the debtor; each restricts it only to exceptional cases.
4. Under Hanafi rules, the creditor is enforcing against the paymaster the debtor's debt owed to the creditor. On the other hand, under Maliki rules, the creditor is enforcing against the paymaster the paymaster's debt against the debtor. Accordingly, under Hanafi law, when sued by the creditor, the paymaster may raise the debtor's, but not his own, defences. Conversely, under Maliki rules, the paymaster may raise against the creditor his (but not the debtor's) defences.
5. However, as towards the creditor attempting to recover from the paymaster, Hanafi rules release the debtor's guarantors; whether they also discharge proprietary securities supporting the debtor's obligation remains contested. At the same time, under Maliki law, both personal and proprietary securities given to support the paymaster's obligation are enforceable by the creditor.

<sup>59</sup> The question is thoroughly discussed by Chéron and Fahmy Bey, above n 31 at 177–82. In any event, note that when the property subject to proprietary securities is provided by a third person other than the original-debtor-transferor, discharge can be rationalized on the same grounds as that applicable to the discharge of personal guarantors.

<sup>60</sup> See text and n 43 above.

<sup>61</sup> For these rules see text and n 59 above.

On the basis of the foregoing discussion, the following two complementary observations are to be made on the legal nature of the *hawale* by reference to legal mechanisms that developed in Roman law:

- I. Indeed, the underlying theory of *hawale* is that of substitution of debtors; this distinguishes it from the cession which is premised on the substitution of creditors. However, as indicated, under all Islamic schools other than the Hanafi, the *hawale* is established by the agreement between the original debtor-transferor and the creditor, with no resort whatsoever to the consent of the paymaster-transferee (namely, the debtor to the original debtor); in this framework, its mode of establishment and consequences are quite the same as that of the *cessio* under Roman law.<sup>62</sup> Specifically, other than under Hanafi law, and notwithstanding what may be the orthodox view to the contrary,<sup>63</sup> the *hawale* operates in the same way as the non-recourse outright assignment for value of debt.<sup>64</sup>
- II. Conversely, in Hanafi law, the *hawale* is established by the agreement of the paymaster-transferee and the creditor. In this framework, the mode of operation and consequences of the *hawale* are quite analogous then to the perfect execution of a delegation order under Roman law.<sup>65</sup>

### 2.3 Codification of Hanafi Law: The *Hawale* under the Mejlle

As of the sixteenth century CE, Hanafi law had enjoyed exclusive official recognition in the entire Ottoman Empire.<sup>66</sup> On civil matters it became the law of the land; the process culminated with the promulgation in 1877 of the Mejlle as the Ottoman Civil Code. The Mejlle is the first attempt to codify Islamic law; ‘derived entirely from Hanafi law,’<sup>67</sup> its stated purpose was to provide the

<sup>62</sup> For *cessio* in Roman law see n 30 above.

<sup>63</sup> Thus, sources cited in n 34 above deal with the *hawale* as a ‘delegation’.

<sup>64</sup> In the pre-2001 *Official Texts of the American Uniform Commercial Code* (eg 1962, 1972, and 1978), Official Comment 1 to §9-308 set out the various arrangements for the assignment of debts under modern law and practice.

<sup>65</sup> In its narrow sense, ‘delegation’ has been defined in Roman law as an order given by one person (‘delegant’) to another (‘person to be delegated’) to pay, or assume an obligation towards, a third person (‘delegatee’). In its broader sense, it has come also to include the execution of the order. For the definition of *delegatio* see eg Berger, above n 30 at 429. For the perfect execution by means of novation by stipulation in Roman law see a particularly comprehensive and useful discussion by S Maxwell, *De la Délégation en Droit Romain* (Bordeaux: Imprimerie Ve Cadoret 1895) at 55–57 and 67–105. See also this book ch 5, section 6 above. I disagree with Tyan, ‘Cession’, above n 22 at 29 who treats the *hawale* under Hanafi law as a cession. His analysis is stated (at 28, fn7) to be limited to a restricted *hawale*, for which however, in connection with Art 693 of the Mejlle, an alternative explanation is provided in text around nn 97–98 below.

<sup>66</sup> See Schacht, *Introduction*, above n 21 at 65 and 89–93. At its peak, the Empire extended from Anatolia to west of the Bosphorus in the North, and from Mesopotamia and west Arabia to the western Mediterranean in the south. For a map, visit [www.en.wikipedia.org/wiki/Image:Ottoman\\_small\\_animation.gif](http://www.en.wikipedia.org/wiki/Image:Ottoman_small_animation.gif).

<sup>67</sup> Coulson, above n 1 at 151.

recently created secular courts with 'an authoritative statement of the doctrine of Islamic law.'<sup>68</sup> In many lands which had previously formed the Ottoman Empire, the Mejlle, at least in part, survived as a civil code, long after the dismantling of the Empire itself after World War I.<sup>69</sup> Indeed, the Mejlle was passed centuries after the early Medieval period; strictly speaking, it cannot be taken as a precise record of the law of that period. Possible gaps in our knowledge may exist; as well, fine-tuning and resolution of some points may have taken place over the centuries. Nevertheless, for our purposes, it may be useful to examine the Mejlle provisions governing the *hawale* as a statutory embodiment of Hanafi law doctrine, and as such as an indication of an outline pertaining to, and in general confirming, the content of the Medieval law.

The *hawale* is governed by Book IV of the Mejlle (consisting of Articles 673–700).<sup>70</sup> It is defined in Article 673 as a transfer of a debt from its debtor to another person. It was judicially described in Cyprus as 'a transaction in which one person assumes the obligation of another.'<sup>71</sup> In the language of Articles 674–677, the original debtor, who is described as the *hawale* maker, is the *Muhil*. His creditor is the *Muhal*. The new debtor, 'who accepts a *hawale* to himself,' is called *Muhal aley-h*. Finally, the 'the thing which is transferred by *hawale*' is *Muhal bih*.

In our terminology, the participants in a *hawale* are, respectively, the debtor (corresponding to the transferor or *Muhil*), the creditor (corresponding to the *Muhal*), and the paymaster (corresponding to the transferee or *Muhal aley-h*). According to Article 688, the debt subject to the *hawale*, namely, the debt owed by the debtor to the creditor and taken over by the paymaster, must be for a

<sup>68</sup> Schacht, *Introduction*, above n 21 at 92, relying on the explanatory memorandum. One stated rationale was the fact that 'the Hanefite school did not crystallize . . . but . . . has split up into innumerable sections and opposing sub-divisions.' See Report of the Commission Appointed to Draft the Mejlle, reproduced in Hooper, above n 28 vol I at 1, 3. See also Coulson, *ibid* at 151–52.

<sup>69</sup> For some information see Schacht, *ibid* at 93. In Israel, particularly with the ongoing passage of laws envisaged to become part of a modern civil code, the application of the Mejlle provisions had been gradually eroded but it was repealed as a binding law only as late as 1984. See *Repeal of Mejlle Law, 5744/1984, Laws of the State of Israel: Authorized Translation from the Hebrew* (Jerusalem, Israel: Government Printer, 1948–89) vol 38 at 212. The full text can be viewed at [www.geocities.com/savepalestinenow/israellaws/fulltext/repealofmejlle.htm](http://www.geocities.com/savepalestinenow/israellaws/fulltext/repealofmejlle.htm). In recent decades the Mejlle has gained fresh attention as seen in the codification of the new Civil Code of the United Arab Emirates in 1985. Visit: [www.amazon.com/Mejlle-Complete-Code-Islamic-Civil/dp/9839541129](http://www.amazon.com/Mejlle-Complete-Code-Islamic-Civil/dp/9839541129).

<sup>70</sup> *The Mejlle*, trans by CR Tyser (Lahore: All Pakistan Legal Decisions, 1967, reprint 1901 edn). Another translation is that of Hooper, above n 28 vol I, of which *Book IV: Transfer of Debt* is reproduced in the *Arab Law Quarterly*, vol 2 No 3 (August 1987), 311 and can be visited at: [www.links.jstor.org/sici?sici=0268-0556\(198708\)2%3A3%3C311%3ATMBITO%3E2.0.CO%3B2-B](http://www.links.jstor.org/sici?sici=0268-0556(198708)2%3A3%3C311%3ATMBITO%3E2.0.CO%3B2-B). For an analysis of these provisions under the laws of Palestine and Israel as they were at the time see Z Zeltner, *Law of Contracts General Part* (Tel Aviv: Avukah, 1963) [in Hebrew] vol I at 360–72.

<sup>71</sup> *Hussein Mustafa v Osman Ismael* (1909) 8 Cypr. L.R. 125 at 127. See also *Imperial Ottoman Bank v Limbouri* (1897) 4 Cypr. L.R. 48 at 50 speaking of the *hawale* as contemplating the transfer of a debt in the sense of 'the substitution of one debtor for another.' To a similar effect in Israel see CA 492/60, *Moral v Karbatzov*, 15 PD 1776, at 1785 (SC) [in Hebrew].

fixed sum<sup>72</sup> and may be ‘any debt, for which a good guarantee can be given.’ Per Articles 612 and 631 it must then arise from an existing obligation.<sup>73</sup>

The Mejlle enumerates four alternative methods for the creation of a binding *hawale* which can thus be established:

1. By the unilateral declaration of the debtor to the creditor followed by the acceptance of the creditor and paymaster (Article 680);
2. By means of a contract concluded between the creditor and the paymaster (Article 681);
3. By means of a contract concluded between the debtor and creditor followed by the acceptance by the paymaster ‘after notice’ (Article 682); or
4. By the agreement of the debtor and paymaster, in which case it becomes a concluded contract ‘subject to the acceptance of the creditor’ (Article 683).

All methods other than the second effectively require the agreement and consent of all three participants. In contrast, the second method dispenses with the consent of the debtor and permits the *hawale* to be established on the basis of the bilateral agreement between the paymaster and creditor. Effectively then, and as a codification of Hanafi doctrine, the establishment of the *hawale* does not hinge on the consent of the debtor, but rather draws on the agreement between the paymaster<sup>74</sup> and the creditor,<sup>75</sup> to which the debtor’s agreement or consent may be added and yet is irrelevant. In other words, a *hawale* can be made even over the objections of the debtor.<sup>76</sup>

Indeed, a bilateral agreement, between either the debtor and creditor or the debtor and the paymaster, is binding on them, though only pending the acceptance by the third participant, namely the paymaster in the first case and the creditor in the second one.<sup>77</sup> Otherwise, among the three methods premised on

<sup>72</sup> To that end, under Art 688, ‘if someone says “I have accepted by way of hawale what it shall be proved you have to receive from such a one, the hawale is not good”’.

<sup>73</sup> Certainly, the ‘guaranteeable debt’ requirement is indication to the drafters’ adherence to the Hanafi school. For the Hanafi classification of the *hawale* as a contract or guarantee see text and n 36 above.

<sup>74</sup> However, at least with respect to a restricted *hawale* (to be discussed further below) in which the debtor instructs the paymaster to pay the creditor out of what the paymaster owes the debtor, it was historically debated whether the consent of the paymaster is required. In support, it was acknowledged that the paymaster’s terms of indebtedness do not vary by the mere change of creditors, and yet it was argued that the paymaster may be disadvantaged by being required to pay a more demanding or harsher creditor. See Chéron and Fahmy Bey, above n 31 at 149–50.

<sup>75</sup> With respect, I do not follow Tyan, who highlights the principal role of the paymaster’s consent towards the debtor and goes on to state that ‘the consent of the creditor is a necessary element but not essential of the [*hawale*] contract.’ See Tyan, ‘Transport’, above n 46 at 26.

<sup>76</sup> It is however possible that a debtor who has not consented may not be liable to be sued by the paymaster for reimbursement, in which case the paymaster’s recourse may then be limited to debtor’s assets available under his hands (including a debt owed to him). The theory behind this limitation is that an honourable person is unlikely to agree that a stranger will pay his debt. See Chéron and Fahmy Bey, above n 31 at 147–48. As indicated in n 41 above, Chehata, above n 21 at 100 is more definite in stating that recourse is not available against a non-consenting debtor.

<sup>77</sup> Cf Tyan, ‘Transport’, above n 46 at 35, speaking of the irrevocability by the debtor of his agreement with the paymaster, pending the acceptance by the creditor.

a three-way agreement, that is, all methods other than the second, the difference is only in the chain of communication, which may give a different role to the agreement or consent of a participant. For example, while the paymaster's acceptance is required under the fourth method for the initial creation of the *hawale*, under the first and third methods it is required in order to complete a *hawale* already agreed or declared. As well, the first method presumably envisages that all three participants, or at least the creditor and the paymaster, are to be present at the same time in the same place; conversely, the third method must be taken to contemplate that the paymaster is not present at the time of the agreement between the debtor and creditor.<sup>78</sup> Either way, all methods other than the second one envisage situations in which the *hawale* is created by means of the consent and agreement of all three participants. And yet, as indicated, in the final analysis, it is the paymaster-creditor bilateral agreement that forms a binding *hawale*.

Overall, the participants are not required to be present together at the time and place of the conclusion of the *hawale*; the interpretation of Article 680 as possibly envisaging a presence-of-all-three scenario is designed only in order to distinguish the case governed by it from that governed by Article 682. Under all four methods, and regardless of the order of communication, no particular formality is mandated for the creation of a binding *hawale*. It can be made either orally or in writing, either explicitly or implicitly, and either in advance or retroactively.

The *hawale* is concerned with the transfer of an obligation from its original debtor to a new one, or in our terminology, from the debtor to the paymaster. As already indicated, it is distinguishable from the Roman *cessio*<sup>79</sup> which is concerned with the transfer by one person to another of an entitlement to a debt owed to the former. In our scenario, a *cessio* would be the transfer by the debtor to the creditor, of the entitlement to the debt owed to the debtor by the paymaster. Conversely, the *hawale* is the transfer from the debtor to the paymaster of the obligation, namely the liability, to pay the debt owed by the debtor to the creditor; it is a matter to be agreed upon between the creditor and the paymaster. The Roman *cessio*, being in our case a cession or assignment of a debt owed to the debtor, is a matter between the 'cessionaire'/'assignor' (the debtor in our

<sup>78</sup> Thus, in contrast to Art 682, Art 680 does not envisage a separate notice given to the paymaster that is thus to be taken as present with the creditor, at the time the debtor's declaration is made. However, Art 680 may not preclude the communication of the debtor's declaration to the creditor other than by being together with him at the same place. At the same time, the example given for the operation of Art 682 is that of 'someone [who] makes a *hawale* of his creditor to the account of someone, *who is in another country*,' who subsequently 'and after the creditor has accepted . . . after notice, also accepts,' and thus is not present at the time the *hawale* is agreed between the debtor and creditor. (Emphasis added.)

<sup>79</sup> The distinction between these two institutions along the lines set out below was noted in Cyprus in *Hussein Mustafa* above n 71 at 127, which was followed in the British Mandate of Palestine in CA 96/42, *Kremenetzky (Administrator of the Estate) v Anglo-Palestine Bank*, 9 P.L.R. 559 at 564 (S.C.) and CC Haifa 187/46, *Palestine Land Development Co v Yalonetsky* 1947 S.C.D.C. 91 at 93. The distinction was subsequently endorsed by the Supreme Court of Israel in CA 352/58, *Levin v Rehovot*, 45 P.E. (S.C.J.) 196 at 201 [in Hebrew].

case) and the ‘cessionary’/‘assignee’ (being the creditor in our case) and does not require the consent of the ‘account debtor’ (in our case the paymaster).<sup>80</sup>

At the same time, by comparison to Roman law, the *hawale* appears to operate very much – though as will be seen immediately below, not exactly – like the first case of a qualified delegation executed by the paymaster’s undertaking to pay the creditor the debt owed by the debtor to the creditor.<sup>81</sup> It involves novation by means of the replacement of the debtor owing on the debtor’s obligation to the creditor;<sup>82</sup> in this case, the transfer of a debt or passive obligation takes place, so that the paymaster becomes liable to the creditor on the debtor’s original obligation, and hence, only to the extent that the debtor would have owed the creditor.

The consequences of the *hawale* are stated in Article 690 to be the discharge of the (original) debtor, as well as the release of any pledge or guarantee provided to secure his discharged original obligation. In turn, ‘the right to demand *that debt* from the person, who accepts the *hawale*, is established for the creditor’ (emphasis added). To that end, per Article 697, while an agreement to the contrary is not precluded, the time in which the paymaster is to pay the creditor is the same as the time the debtor would have been required to pay. It logically follows that the paymaster may invoke against the creditor any defence that would have been available to the debtor against the creditor.<sup>83</sup> It would have further followed that the creditor remains entitled to the benefit of all securities given by the debtor; however, as was already indicated, on that latter point Article 690 explicitly provides for the opposite, namely for the forfeiture of all pledges and guarantees supporting the debtor’s original obligation.<sup>84</sup>

As indicated, Article 690 indicates the discharge of the original debtor-transferor as a consequence of the *hawale*. Nevertheless, in the footsteps of Hanafi doctrine, and notwithstanding what may be its plain meaning to the contrary, Article 690 is interpreted to read that discharge of the debtor is conditional; in fact the paymaster’s acceptance of the *hawale* operates to suspend the debtor’s obligation pending payment by the paymaster. Otherwise, upon the latter’s default, recourse is available to the creditor against the debtor, though

<sup>80</sup> For the *cessio* in Roman law, see n 30 above.

<sup>81</sup> The various types of delegations are discussed by Maxwell, above n 65 at 55–57 and 88–95 (particularly 90–92). See in this book ch 5, section 6.2 above.

<sup>82</sup> But cf Chéron and Fahmy Bey, above n 31 at 173 who reject the novation theory, albeit overlooking the possibility of a novation by the mere substitution of parties.

<sup>83</sup> Which is indeed the conclusion of Chéron and Fahmy Bey, *ibid* at 174–75, who further explain that in Islamic law such defences include the extinction of the debt owed by the debtor to the creditor by the automatic setoff between that debt and a debt owed by the creditor to the debtor arising prior to the *hawale*. For the availability to the paymaster of all defences to an action on the transferred debt (namely the debt owed by the debtor to the creditor) see also Tyan, ‘Transport’, above n 46 at 31.

<sup>84</sup> In the absence of a recourse against the debtor, forfeiture of guarantees (as well as of proprietary securities provided by third parties) may nonetheless be logically explained by the reliance of a guarantor (as well as a third-party securities provider) on the personal liability of the debtor (and not the paymaster) against whom he is entitled, upon payment to the creditor, to indemnity. See eg Tyan, ‘Transport’, above n 46 at 34–35 and text and n 59 above.



only in specified narrow circumstances, such as the insolvency of the paymaster, at least after his death, as well as when the paymaster-transferee denies the *hawale* which nevertheless cannot be proven by the creditor.<sup>85</sup> As will be seen further below, recourse against the original debtor is stated to be available to the creditor in a restricted *hawale*, namely, one stated to be payable out of a designated fund or upon the fulfilment of another condition, but only where the paymaster's obligation to the debtor is void.

According to Articles 699–700, the person who accepts a *hawale*, that is, the paymaster in our scenario, is discharged from his engagement<sup>86</sup> when he:

- (a) pays the debtor's debt owing to the creditor;
- (b) makes a subsequent *hawale*;<sup>87</sup>
- (c) receives an acquittance from the creditor;
- (d) accepts from the creditor the subject-matter of the *hawale* as a gift or alms; or
- (e) becomes the heir of the creditor upon the latter's death.

The Mejlle provides for a detailed scheme governing the relationship between the paymaster and the debtor. In principle, according to Article 698, prior to making payment to the creditor, the paymaster 'has no claim on the debtor.'<sup>88</sup> Upon making the payment, the paymaster's claim against the debtor is limited to 'the thing which is the subject of the *hawale*,'<sup>89</sup> and yet, the method of enforcement of the claim depends on the circumstances.

To begin with, the Mejlle distinguishes between an absolute and restricted *hawale*. An absolute *hawale*, or *hawale mutlaqua*, is defined in Article 679 'not [to be] restricted for payment to be made from property of the [debtor], or in the hands of the [paymaster].' Stated otherwise, an absolute *hawale* is not stated to be paid out of a debt owed by the paymaster to the debtor. Conversely, under Article 678, a restricted *hawale*, or *hawale muqayyede*, is 'a *hawale* restricted by a stipulation, for the [paymaster] to pay from the property of the [debtor], owed to him by the [paymaster], or in the hands of the [paymaster].'

<sup>85</sup> For the Hanafi doctrine on the point, see text and nn 46–47 above. For the interpretation by the Mejlle according to this doctrine see Chéron and Fahmy Bey, above n 31 at 162–67 and Tyan, *ibid* at 28–29. The controversy regarding an insolvent living paymaster has to do with the possible transformation of his position which is obviously impossible for an insolvent estate of a dead paymaster. *Ibid*.

<sup>86</sup> In all cases enumerated below, discharge is absolute. According to Chéron and Fahmy Bey, above n 31 at 182–83 this is so also in connection with discharge by making a subsequent *hawale*, upon which the original debtor-transferor's obligation remains suspended while that of the paymaster-transferee (becoming a second transferor) is absolutely discharged.

<sup>87</sup> Which could be a mechanism for the circulation of credit as under Roman law as discussed in ch 5, section 10.2 above and touched upon in n 228 and text below. As to the *hawale* as an instrument for the circulation of credit see text and n 122 below.

<sup>88</sup> Strictly speaking, Art 698 deals with a paymaster who 'has paid the debt.' *Quaere* whether or to what extent it also covers discharge by any other method as provided by Arts 699–700 discussed above.

<sup>89</sup> Art 698 which goes on to provide the following example: 'If . . . the subject of the [*hawale*] is silver [coins] and [the paymaster] pays gold, he takes from the debtor . . . silver [coins], he cannot demand gold.' Chéron and Fahmy Bey, above n 31 at 156–57 analyse the situation as subrogation.

Stated otherwise, a restricted *hawale* typically provides that it is payable out of a debt owed by the paymaster to the debtor.<sup>90</sup>

It is to be noted that the distinction between a restricted and unrestricted *hawale* is not on the basis of whether the paymaster is indebted to the debtor; rather, it is on the basis of whether payment by the paymaster to the creditor is *stated* to be out of a debt, namely, out of an amount due on a debt, owed by the paymaster to the debtor, and thus dependent on the existence of such a debt. Certainly, a restricted *hawale*, payable out of a debt owed by the paymaster to the debtor, is premised on the existence of such a debt and is irreconcilable with its absence. On the other hand, an absolute *hawale* is consistent either with the existence or absence of a debt owed by the paymaster to the debtor. It is premised instead on the obligation of the paymaster to the creditor being independent of the existence of a debt owed by the paymaster to the debtor, regardless of whether such a debt exists. The absolute *hawale* is thus reconcilable with both the existence and absence of a debt owed by the paymaster to the debtor.

Accordingly, with regard to a paymaster who paid the creditor in discharge of the debt assumed under an absolute *hawale*,<sup>91</sup> Article 691 distinguishes between two situations.<sup>92</sup> The first is the case in which the debtor ‘has nothing to receive from the person who accepts the hawale,’ namely, where the debtor is not owed by the paymaster. The second case is ‘where there is anything to receive.’ In the former case, after payment to the creditor, the paymaster who did not owe the debtor ‘can claim against’ the debtor, that is, he is entitled to be indemnified by him. In the latter case, upon making payment to the creditor, a paymaster who owed the debtor is entitled to a discharge from the debtor by offsetting his claim to an indemnification from him.<sup>93</sup>

No such distinction exists with respect to a restricted *hawale*; having paid out of a debt owed to the debtor, the paymaster must be taken to have gotten his discharge vis-a-vis the debtor to the extent of the payment. Furthermore, under Article 692, in a case of a restricted *hawale*, the debtor’s claim to the debt owed to him by the paymaster, on which the restricted *hawale* is premised, ‘ceases’, so that the paymaster ‘can no longer’ pay it to the debtor; or else if he pays it to the debtor, he does it at his risk.<sup>94</sup>

<sup>90</sup> Alternatively, per Art 696, a restricted *hawale* may be stated to be payable ‘from the price realised on the sale of fixed property of his own’ in which case the paymaster ‘is bound to pay the creditor from the price realised on the sale of that property.’

<sup>91</sup> Strictly speaking, Art 691 speaks of ‘payment’ by the paymaster. *Quaere* whether or to what extent it also covers discharge by any other method as provided by Arts 699–700 discussed above.

<sup>92</sup> Regardless, as indicated, per Art 698, no right against the debtor arises in favour of the paymaster prior to actual payment; a paymaster owing to the debtor remains so liable.

<sup>93</sup> As indicated in n 76 above, notwithstanding the silence of the Mejlle on the point, it may well be that the former, namely an action (as opposed to a setoff), is not available to a paymaster against a debtor who has not consented to the *hawale*.

<sup>94</sup> The provision goes on to state that a paymaster who nevertheless paid the debtor ‘is liable to make compensation’ to the creditor and upon making compensation, he becomes entitled to claim back from the debtor, and where the debtor dies, he is even entitled to a priority vis-a-vis competing creditors’ claims to the debtor’s estate.

The *Mejelle* is however silent as to the impact of an absolute *hawale* on a debt the paymaster may owe the debtor. Indeed, one may have thought that already upon his acceptance on which (under Article 690) his liability to the creditor arises and replaces that of the debtor, a paymaster owing to the debtor is to be absolutely discharged vis-a-vis the debtor. This is however not taken to be the legal position. Rather, in line with the Hanafi thinking on the matter, the acceptance of the *hawale* by the paymaster does not affect his legal relationship with the debtor; side by side with his liability to the creditor (under Article 690), a paymaster who accepts an absolute *hawale* remains liable to the debtor until the paymaster pays the creditor.<sup>95</sup> In fact, continued liability towards the debtor notwithstanding the acceptance of the *hawale* can possibly be read as a negative implication from Article 698, providing that prior to payment the paymaster who accepted a *hawale* ‘has no claim against the debtor’.

Upon accepting an absolute *hawale*, the paymaster’s liability to the debtor is not suspended; rather, until payment to the creditor the paymaster is exposed to actions from both the debtor and creditor. Payment to the debtor will not discharge the paymaster towards the creditor;<sup>96</sup> conversely, actual payment to the creditor will discharge the paymaster not only on his acceptance to the creditor (per Article 699), but also on his original debt to the debtor (per Article 691).

As already indicated, under Article 690, the *hawale* establishes in the creditor’s hands ‘the right to demand . . . from the person who accepts the *hawale*’, that is the paymaster, payment of the debt owed to the creditor by the original debtor. It ought to follow that in the case of an absolute *hawale*, not made conditional or dependent on the debt owed by the paymaster to the debtor, a paymaster who owes the debtor may not defend the creditor’s claim on the basis of defences the paymaster has against the debtor.<sup>97</sup> Under Article 693, this is also generally true in the case of a restricted *hawale*.<sup>98</sup>

However, for a restricted *hawale*, three exceptions are stated to exist. First, under Article 693, in the case of a restricted *hawale* in which the paymaster is to pay out of a debt owed to the debtor for the price of goods, the paymaster is released towards the creditor upon the successful assertion by a third party of an adverse claim to the goods for which the price is due. Second, under Article 694, in the case of a restricted *hawale* in which the paymaster is to pay out of a deposit owed by the paymaster to the debtor, the paymaster is released towards the creditor upon the successful assertion by a third party of an adverse claim to

<sup>95</sup> See Chéron and Fahmy Bey, above n 31 at 155.

<sup>96</sup> Albeit presumably, upon payment to the creditor, a paymaster who earlier paid the debtor is entitled to reimbursement from him under Art 691.

<sup>97</sup> Tyan, ‘Transport’, above n 46 at 31–32.

<sup>98</sup> Strictly speaking, the provision deals only with the case of a restricted *hawale* in which the paymaster is to pay out of a debt owed by him to the debtor for the price of goods, in which case the paymaster is not released towards the creditor even ‘if the price can no longer be claimed [by the debtor/seller] in consequence of the thing sold being destroyed before delivery, or if the thing sold is returned under a condition giving an option, or an option on inspection, or an option for defect, or, if the sale is rescinded.’

the deposit. Third, under Article 695, in the case of a restricted *hawale* in which the paymaster is to pay out of the debtor's money held by the paymaster, the paymaster is released towards the creditor where that money is lost or destroyed in circumstances for which the paymaster does not become liable to the debtor for the loss or destruction.<sup>99</sup>

In all three cases the restricted *hawale* is stated to become void, so as to refasten the obligation to pay the creditor on the original debtor. For that to happen, it is not enough for the paymaster's obligation to the debtor, out of which payment to the creditor to be made, to be voidable. As well, it is not enough for that paymaster's obligation to be otherwise subject to defences. This is so even when on such or any other grounds that paymaster's obligation was rescinded or otherwise effectively terminated. Rather, the paymaster's obligation must be void *ab initio*. As well, arguably along similar lines, as a matter of principle, in a restricted *hawale* in which the paymaster is to pay out of a debt owed to the debtor or out of any other fund, the paymaster's obligation is subject to the existence and amount of the debt or fund, though as indicated, not to defences to liability on the debt or for the payment of the fund.<sup>100</sup>

In fact, for a restrictive *hawale*, this distinction between a condition as to the existence of the debt and as to the availability of defences thereon, is a matter of interpretation of the stipulation providing for the condition. Indeed, under the *Mejelle*, the *hawale* renders the paymaster liable to the creditor on the debt owed to the creditor by the original debtor and not on the debt owed by the paymaster to the debtor. This is true for both an absolute and restricted *hawale*. The latter may however be stated to be conditional on the existence of a debt owed by the paymaster to the debtor. Unless it is stated to be conditional on lack of defences available to the paymaster against the debtor, a *hawale* stated to be conditional on the existence of a debt owed by the paymaster to the debtor is to be construed as conditional on the mere existence of the debt. In this context, the debt owed by the paymaster to the debtor is deemed to exist also when the action on the obligation to pay that debt can successfully be defended, and even when that obligation has been effectively repudiated.<sup>101</sup>

<sup>99</sup> In all three cases the paymaster is said to be released from his liability to the creditor; according to Chéron and Fahmy Bey, above n 31 at 159–60, having already paid the creditor prior to learning of circumstances that would have released him, the paymaster is to be entitled to restitution from the creditor.

<sup>100</sup> This may be implied from Art 696, governing the obligation of the paymaster to pay 'from the price realised from the sale of fixed property of his own' in which case he 'is bound to pay the creditor from the price realised on the sale of that property.' Certainly however, a paymaster who misled the creditor as to the existence or size of the debt out of which a restricted *hawale* is to be paid may be liable to the creditor on grounds other than his acceptance of the *hawale*.

<sup>101</sup> It is particularly the latter situation, based on a distinction between a void contract and a contract that has been effectively rescinded or repudiated, which I find unsatisfying. Cf Tyan, 'Transport', above n 46 speaking at 33 of difficulties in the language of Arts 694–695.

### 3. THE SUFTAJ AND OTHER ISLAMIC PAYMENT INSTRUMENTS: THE HAWALE APPLIED

#### 3.1 Islamic Payment Instruments and the *Hawale*: An Overview

Documentation of Islamic payment instruments is quite rich;<sup>102</sup> this is particularly true for the period of the Fatimid Caliphate, which was in power between the tenth and twelfth centuries.<sup>103</sup> Approximately from that period, or more specifically, between the eleventh and thirteenth centuries, plenty of documents<sup>104</sup> originate from the Jewish *Geniza* of Cairo.<sup>105</sup>

Islamic payment instruments have not always acquired distinct names. Thus, the withdrawal out of an account with a *sarraḥ* (private moneychanger) in the execution of a non-cash payment made by a small retailer to his wholesaler may be treated simply as a *hawale*.<sup>106</sup> In turn, more specialized terminology, though not necessarily uniform or precise, has also developed.<sup>107</sup> Thus, the *ruq'a* has a few meanings. First, it means an order for the delivery of goods. Second, it is a payment order, issued to the payee, instructing the paymaster to make payment against its presentment by the person entitled to obtain payment. Third, it

<sup>102</sup> See eg SK Bakhsh and DS Margoliouth, *The Renaissance of Islam* (trans from the German of Adam Mez) (Patna: Jubilee, 1937) at 476–77; and E Ashtor, 'Banking Instruments Between the Muslim East and the Christian West' (1972) 1 *Journal of European Economic History* 553 reprint (with same pagination) in E Ashtor, *East-West Trade in the Medieval Mediterranean* (BZ Kedar, ed) (London: Variorum Reprints, 1986). For summary and sources see eg Ray, above n 34 at 66–79.

<sup>103</sup> For the Fatimid Caliphate visit [www.en.wikipedia.org/wiki/Fatimid](http://www.en.wikipedia.org/wiki/Fatimid).

<sup>104</sup> A most recent comprehensive definite study analysing the various *Geniza* payment instruments is by A Shvitiel, 'Orders of Payment, Order of Supply, Instructions for Payment, and Statement of Credit in the Genizah and other Collections at Cambridge University' in B Outhwaite and S Bhayro, 'From a Sacred Source' – *Genizah Studies in Honour of Professor Stefan C. Rief* (Lieden & Boston: Brill, 2011) at 331 who builds on earlier work, particularly (*ibid* at 331) on the 'monumental book' of SD Goitein, *A Mediterranean Society* (Berkeley and LA: University of California Press, 1967) vol I: Economic Foundations at 240–50. Other sources are indicated in n 111 below. According to Shvitiel (*ibid* at 332), 134 documents have so far been discovered. He classifies them as mercantile payment order, orders for the delivery of goods, administrative payment instructions, and acknowledgements of debts.

<sup>105</sup> For the Cairo *Geniza* in general, see SC Reif, *A Jewish Archive from Old Cairo, The History of Cambridge University's Genizah Collection* (Surrey, Richmond: Curzon, 2000). *Geniza* (or *Genizah*) is a Hebrew word denoting the store-room or depository in a synagogue, usually specifically for worn-out Hebrew-language books and papers on religious topics that were stored there before they could receive a proper cemetery burial, it being forbidden to throw away writings containing the name of God (even personal letters and legal contracts could open with an invocation of God). In practice, a *Geniza* may have contained writings of a secular nature, with or without the customary opening invocation, and also contained writings in other languages that use the Hebrew alphabet (see eg [www.en.wikipedia.org/wiki/Geniza](http://www.en.wikipedia.org/wiki/Geniza)). Secular documents in the Cairo *Geniza*, such as payment instruments, were mostly written in Judeo-Arabic (an Arabic dialect using Hebrew alphabet) and may have contained the invocation of God.

<sup>106</sup> For this practice see text and nn 16–18 above. Certainly however, the document implementing the *hawale* could be a *ruq'a* or *sakk* discussed in the text that immediately follows.

<sup>107</sup> For the *sakk* and *suftaj* see eg CE Bosworth, 'Abū 'Abdallāh Al-Khwārazmī on the Technical Terms of the Secretary's Art: A Contribution to the Administrative History of Mediaeval Islam' (1969), 12 *Journal of the Economic and Social History of the Orient* 8, respectively at 125 and 140.

denotes the paymaster's own obligation to pay, or in fact, any promissor's debt or acknowledgement of debt instrument.<sup>108</sup> The first sense is outside the scope of the present study; in both the second and third senses, which are of interest in the context of the present study, the *ruq'a* overlaps with the *sakk*, from which, linguistically, the modern word 'cheque' may be derived.<sup>109</sup> In fact the second and third meanings may converge; this is so, since the paymaster's obligation to pay on a *ruq'a* or *sakk* is typically in pursuance of the payment order directed to the paymaster which is at least implicit on the instrument. The express terms of the document may however reflect the debtor's order, the paymaster's promise, or both.

Typically, a *ruq'a* or *sakk* does not designate a named payee and is payable to the bearer. As an order to pay addressed to a person acting as a banker, the *ruq'a* and *sakk* correspond to the modern cheque. As a promise to pay, they correspond to the modern promissory note. Being payable to the bearer, and inasmuch as the promissor usually acts as a banker, in the third above-mentioned sense, they in fact correspond more to the post-Medieval English banknote.<sup>110</sup>

A payment instrument to be further discussed is the *suftaj*. This instrument contains an obligation of a paymaster or his correspondent to pay at a place other than that of the issue of the document.<sup>111</sup> It was thus used for payment or transfer of funds between two places, possibly from a debtor to a creditor,<sup>112</sup>

<sup>108</sup> For a *sakk*, from Western Sudan, in effect, in the latter sense, that of an 'IOU' (acknowledgement of debt) document, see eg N Levzion, 'Ibn-Hawqal, the Cheque, and Awdaghost' (1968), 9 *Journal of African History* 223 who nevertheless (not having in mind precise legal terminology) speaks of the document as a 'cheque'.

<sup>109</sup> See eg Goitein, above n 104 at 245.

<sup>110</sup> For the modern cheque as an instrument containing an unconditional order directed to a bank and instructing it to pay on demand, as well as for the promissory note as an instrument containing an unconditional promise to pay, see eg the English *Bills of Exchange Act, 1882* (UK), 45 & 46 Vict., c. 61, ss 73, 83(1) respectively. For the origins of the cheque and banknote (effectively, the forerunner of the promissory note, being a promissory note issued by a banker), see discussion in ch 10, section 2.2 below.

<sup>111</sup> In addition to sources set out in nn 102 and 104 above, various studies in Jewish history mention or reproduce original documents (usually translated to the language of the study, ie, either English or Hebrew) either (mostly) mentioning or constituting *suftajs* (and occasionally other payment orders). Original documents are either in Hebrew or Judeo-Arabic, referring either to *suftajs* or to the Hebrew equivalent, *dyokani* (to be further discussed in this book in ch 7, section 2.4 and section 4 below). Notable examples include: J Mann, *The Jews in Egypt and in Palestine under the Fātimid Caliphs* (New York: Ktav, 1970) vol I at 114, vol II at 125, 144, and 146; EJ Worman, 'Forms of Address in Genizah Letters' (1907), 19 *Jewish Quarterly Review* 721 at 727; Y Ben-Zvi, 'A Letter from a Jewish Merchant from the 11th Century' (1938), 3(NS) *Zion* 179 at 182 [in Hebrew]; J Mann, *Texts and Studies in Jewish History and Literature* (Cincinnati, Ohio: Hebrew Union College Press, 1931) at 143–44; M Gill, *Palestine During the First Muslim Period (634–1099)* (Tel-Aviv: Tel Aviv University, 1983) Part I: Studies at 210, 497, Part II: Cairo Geniza Documents at 134, 150, and 633, Part III: Cairo Geniza Documents and Indexes at 112, 118, 204, and 294 [in Hebrew]; and M Gill, *In the Kingdom of Ishmael* above n 16, vol I: Studies in Jewish History in Islamic Lands in the Early Middle Ages at 497, 555, and 635–41, vol II: Geniza Documents Concerning Babylonia and Persia at 807, vol III: Geniza Merchants' Documents at 813 and 814, vol IV: Geniza Merchants' Documents at 1 and 479 [in Hebrew].

<sup>112</sup> But not exclusively: they could also be used by a traveller who wanted to avoid the risk of carrying money as well as for the purpose of payment to government and donation to pious foundations (such as for gifts to the poor). See sources cited in n 102 above.

particularly over routes serving permanent business connections. In the footsteps of the obligation on a *ruq'a* or *sakk*, the paymaster's obligation on the *suftaj* is in response to a payment order issued to him. However, unlike the *ruq'a* or *sakk*, the *suftaj* is typically payable to a named payee and not to the bearer.<sup>113</sup> The *suftaj* is said not to be transferable;<sup>114</sup> otherwise, it corresponds to the bill of exchange<sup>115</sup> or letter of credit.<sup>116</sup> It raises significant legal issues and thus will be discussed further below in greater detail.

An Islamic payment instrument is not said to incorporate a written formal abstract unilateral obligation;<sup>117</sup> nor does it require any formality in its execution.<sup>118</sup> The payment engagement thereon is binding on the paymaster according to its terms as agreed on between him and the debtor (to whom he owes).<sup>119</sup> The operation of the instrument as a payment mechanism is premised on the transfer from the debtor to the paymaster of the debt obligation owed (originally by the debtor) to the creditor. Transfer is implemented by means of a *hawale*, as a result of which the paymaster becomes obligated to the creditor. As discussed above in section 2.2, this means that under the Hanafi rules the

<sup>113</sup> But cf Goitein above n 104 at 242, as well as AL Udovitch, 'Reflections on the Institutions of Credits and Banking in the Medieval Islamic Near East' (1975), 41 *Studia Islamica* 5 at 16 (hereafter, Udovitch, 'Reflections') and Imamuddin, above n 10 at 29, 30 referring to the 'bearer' of a *suftaj*. See also M Ben-Sasson, *The Growth of the Jewish Community in the Islamic Lands Qayrawān, 800–1057* (Jerusalem: Magnes, 1996) at 99 [in Hebrew, free translation of title]. Possibly, they do not use the term in its technical legal sense and mean 'holder', namely the named payee in possession. In any event, Imamuddin, *ibid* at 29, fn 53 cites a source (AE Sayous, 'Observations d'Erivains du XVe Sicle sur les Changes et Notamment sur l'Influence d la Disparité du Pouvoir d'Achat des Monnaies' (1928), 4 *Revue Économique Internationale* 289 at 293) which in fact deals with thirteenth-century documents in Europe. But see Ashtor above n 102 at 563 (and 557) specifically noting minority of *suftaj* documents payable to the bearer.

<sup>114</sup> See eg Goitein, *ibid* at 245 and Udovitch, 'Reflections', *ibid* at 17. For the view of Huvelin, 'Travaux', above n 5 at 24 ostensibly to the contrary, see n 203 below. For the non-transferability of the *suftaj* as existing regardless of the 'bearer' language that it may have contained (*ibid*), see text around nn 128–29 below.

<sup>115</sup> For the modern bill of exchange as an instrument containing an unconditional order to pay money, on which the drawee becomes liable upon accepting the order, see eg English *Bills of Exchange Act*, 1882 (UK), 45 & 46 Vict., c. 61, s 3(1), in conjunction particularly with ss 17, 23 and 54.

<sup>116</sup> For the modern 'credit' (namely, a letter of credit) as an 'arrangement . . . that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation', see art 2 of the ICC UCP 600, Documentary Credits, 2007 Revision.

<sup>117</sup> As were the Greek *chirograph* and *syngraph*. See F De Zulueta, *The Institutes of Gaius*, Part I: Text with Critical Notes and Translation (Oxford: Clarendon Press, 1946) at 195, and Part II: Commentary (Oxford: Clarendon Press, 1953) at 166. By way of comparison, the *stipulatio* in Roman law was an oral (and not written) formal abstract unilateral obligation. See eg Berger, above n 30 at 716; RW Lee, *The Elements of Roman Law*, 4th edn (London: Sweet & Maxwell, 1956) at 298–304; and B Nicholas, *An Introduction to Roman Law* (Oxford: Clarendon Press, 1962) at 193–96.

<sup>118</sup> Even a signature requirement may be bypassed for one whose handwriting on the document 'was testimony enough to his being the issuer of the order.' See eg Goitein, above n 104 at 241. This appears consistent with the restricted circle of those that have dealt with such instruments. Cf text that follows n 12 above.

<sup>119</sup> Per general requirements of Islamic contract theory set out in text and nn 130–33, below. Most restrictive is Shafi'i law which requires mutual assent to be orally expressed in clearly spoken words. *Ibid*.



paymaster becomes liable to the creditor on the debtor's debt obligation to the creditor; conversely, according to the non-Hanafi schools, the paymaster becomes liable to the creditor on the paymaster's own debt obligation to the debtor.

Indeed, by itself, in the broad sense, the *hawale* is not a distinct type of Islamic payment instrument; rather, in light of the previous discussion, the *hawale* is the legal concept under which such instruments, and even oral agreements, operate as payment mechanisms.<sup>120</sup> To that end, the term is also used to denote any document or arrangement which triggers the application of the *hawale*. It is a bilateral contract<sup>121</sup> between the creditor and either the paymaster-transferee under Hanafi law, or the debtor-transferor according to the other schools. Thus, in Goitein's example of an instrument under which an 'issuer' orders an 'issuing banker' to 'pay to bearer', the 'issuer' is the payer-debtor and the first bearer is the payee-creditor. The 'issuing banker' is the paymaster,<sup>121.1</sup> who, under Islamic law, becomes liable to the payee-creditor on the basis of either his own agreement with the payee-creditor (that is, the first bearer) under Hanafi rules, or the agreement between the debtor and creditor under non-Hanafi law.

Through the circulation of Islamic payment instruments, the *hawale* may facilitate not only the transfer, from the debtor to the paymaster, of the debt obligation owed (originally by the debtor) to the creditor; rather, where needed, it may also facilitate the transfer from the creditor to the paymaster, of the debt obligation owed by the creditor to his own creditor, and onward in an indefinite chain. In the process, the paymaster's obligation to the debtor, 'turns' away from the debtor, first to the creditor, and then onward to a subsequent transferee-creditor of each preceding transferor-creditor. The *hawale* thus facilitates the circulation of the paymaster's obligation on the Islamic payment instrument, and hence, effectively, the entitlement to the debt due on it, from the hands of each creditor to those of his own creditor.<sup>122</sup>

Transferability of the entitlement to the debt due from the paymaster, and hence, the circulation of Islamic payment instruments, is available under the rules of all schools; however, circulation runs more smoothly under the non-

<sup>120</sup> The term is not mentioned in the *Geniza* (see Goitein, above n 104 at 460, fn 63 (for text at 241); arguably, this is so since, unlike the *ruq'a*, *sakk* and *suftaj*, the *hawale* is not a distinct category of a payment instrument. And yet it is quite common to refer to the *hawale* as a financial technique, side by side with the other instruments. See eg Udovitch, 'Reflections', above n 113 at 10; and Udovitch, 'Bankers', above n 9 at 263.

<sup>121</sup> As explained below, this is notwithstanding Rayner who asserts the *hawale* is a unilateral contract. See SE Rayner, *The Theory of Contracts in Islamic Law* (London; Graham & Trotman, 1991) at 307.

<sup>121.1</sup> For this type of instrument, see Goitein, above n 104 at 241. Liability on such an instrument under Jewish law is discussed below in ch 7. But see Shvitiel, above n 104 at 337 who speculates that the person claimed by Goitein to be the 'issuer' is in fact a witness or guarantor.

<sup>122</sup> On this point see Huvelin, 'Travaux', above n 5 at 24. For a similar effect of re-delegation and re-assignment (or re-cession) under Roman law, see ch 5, section 10.2 above. Re-delegation is touched upon in n 228 and text below.

Hanafi rules. This is so since the latter do not require the paymaster's consent or agreement for each transfer.

Indeed, for an effective *hawale*, all schools require a bilateral rather than tri-lateral agreement. For the Hanafi school, under which the *hawale* is premised on an agreement between the paymaster and the transferee-creditor, this is however almost a fiction; by the nature of things, it is the transferor/debtor who is interested in carrying out the *hawale*; after all, it is the debt he owes, which is to be discharged without actual payment on his own part. A *hawale* is thus typically initiated by the debtor; hence, dispensing with the debtor's consent or agreement under the Hanafi school does not really simplify the procedure.

Conversely, inasmuch as the paymaster is typically indifferent as to whom he is to pay, the non-Hanafi schools truly bypass the paymaster's agreement or consent. Thus, in each non-Hanafi school, suffice it for a bilateral agreement between the debtor and creditor to carry out a *hawale*; similarly under non-Hanafi rules, a sequence of ensuing bilateral agreements between each creditor and his own creditor, creates a *hawale* chain. In practice, as will be elaborated further below, each required bilateral agreement can be reached in conjunction with the physical delivery of the instrument reflecting the debt owed by the paymaster to the debtor; hence, circulation is easily facilitated under the non-Hanafi schools.

In contrast, as indicated, the Hanafi school does not effectively bypass the debtor's involvement; moreover, Hanafi rules require the agreement of the paymaster for each transaction. It is the continuous need to seek the paymaster's approval which hinders the circulation of the instruments.<sup>123</sup>

The predominance of the Maliki rules in Egypt may thus explain the abundance of transferable *ruq'a* and *sakk* instruments among the Cairo Geniza documents. This conclusion is however not irrefutable. There may not be adequate information on the extent and geographical scope of actual circulation of the *ruq'a* and *sakk* instruments.<sup>124</sup> In an environment of a limited geographical circulation, it is possible for the instruments to function as payment mechanisms transferring the paymaster's debt obligation from being owed to the debtor to being owed to the creditor, even under Hanafi rules, requiring the paymaster's agreement to confer entitlement on the creditor or transferee. In other words, the Hanafi rules hinder but do not preclude circulation. Moreover, an order to pay the *ruq'a* or *sakk* could operate as a mere authority to the paymaster to pay as well as to the payee to collect, without giving the creditor the benefit of a direct right against the paymaster; this will allow the use of the instruments to carry out a non-cash payment without even invoking the *hawale* to explain their operation.

<sup>123</sup> On this point, see Ray, above n 34 at 62–63 and 79–80.

<sup>124</sup> In fact, an instrument payable to bearer might indicate the purpose of, namely, the underlying transaction for, its issue. Goitein, above n 104 at 241 cites such an example, which may be seen as inconsistent with circulation. Certainly however, there were also '*riqā sayārif*' payable to bearer serving as 'banker notes' which fully circulated: *ibid* at 246. For the moneychangers, called *sarrafs* serving as 'bankers' see section 1 above.

In any event, there may be an alternative, historic rather than analytic, explanation, to the circulation of the *ruq'a* and *sakk* payable to the bearer. Thus, it is noteworthy that *ruq'a* and *sakk* payable to the bearer revived an ancient Near Eastern practice that had existed prior to the invention of coins, and that did not hit roots in Greek or Roman law. Indeed, instruments payable to the bearer go back to Ancient Mesopotamia, or more specifically, to as early as the Old Babylonian Period (2000–1600 BCE) which included the reign of Hammurabi (1792–1750 BCE). Relevant ‘instruments’ were clay tables payable in metal or grain. Possibly, the original purpose of a bearer clause may have had nothing to do with transferability; rather, the clause was inserted on an instrument reflecting a debt owed to temple or palace authorities, for the purpose of enabling any, rather than a specific, representative of such authorities to collect from the debtor and give him a discharge. Subsequently, however, particularly during the Neo-Assyrian and Neo-Babylonian Kingdoms (745–539 BCE), the bearer clause came to facilitate circulation. While it is contested whether a debt payable to the bearer was truly transferable, it is agreed that the obligor was bound by his obligation (or acknowledgement of an obligation) to pay to the bearer; that is, a paymaster/obligor liable on such an instrument could not lawfully resist making payment to whoever presented to him the document containing the bearer clause.<sup>125</sup>

It is thus possible that the circulation of the *ruq'a* and *sakk* payable to the bearer in Egypt (and in fact elsewhere) was premised on the revival of this old practice rather than on the application of the Maliki rules pertaining to the *hawale*. In other words, it cannot be ruled out that the circulation of such paper was based on an ambiguity as to the bearer’s title or claim against the paymaster. The bearer’s title or claim could thus be derivative of the (debtor’s) claim to enforce the paymaster’s obligation on the basic transaction that had given rise to the issue of the instrument; in such a case, title to the *ruq'a* or *sakk* payable to the bearer would be transferable. Alternatively, it could be an original title to a claim, on the very terms of the paymaster’s obligation, to pay a sum of money to the bearer. In the final analysis, however, either way there was a system that worked well without giving an opportunity for its legal ramification to be ascertained.

It may however be more plausible to see the two explanations as not mutually exclusive. Stated otherwise, the revival of an old practice does not negate its accommodation by the contemporary legal doctrine. From this perspective, non-Hanafi law remains more conducive; certainly, it is the Hanafi rules that are

<sup>125</sup> Bogaert, *Les Origines*, above n 8 at 55, 66, 73–74, 94–96, 100, as well as 123–24 and 129. Tablets containing such a clause, are compiled by AH Pruessner, ‘The Earliest Traces of Negotiable Instruments’ (1928), 44:2 *The American Journal of Semitic Languages and Literatures* 88, who further attests to the compliance of the instruments he examined with other formal requirements of negotiability under modern law, such as signature, unconditional promise or order, and certainty as to the time the instrument is payable. Certainly, there is nothing to support full negotiability, in the sense of transferability free from adverse claims and defences of these tablets. See discussion in ch 3, section 2, text and nn 40–42 above.

still to be viewed as detrimental to the circulation of debt instruments, whether or not they are payable to the bearer.

In any event it is noteworthy that even under non-Hanafi rules, transferability by delivery of Islamic payment instruments falls short of 'negotiation' in a few fundamental ways. Thus, in the modern sense of the word, 'negotiation' is the transfer of an instrument by its holder by means of its delivery, plus, other than for instruments payable to the bearer, the endorsement of the holder.<sup>126</sup> Transfer by negotiation may confer on a transferee a better title than that of the transferor, free of defences of prior parties and adverse claims; hence an instrument transferable by negotiation is 'negotiable'.<sup>127</sup>

Even under non-Hanafi rules facilitating circulation by delivery, these requirements are not met in several respects. First, there is no rule under which the mere delivery constitutes a transfer; doctrine requires an agreement between the paymaster and the creditor. Whether such an agreement can be derived from the mere delivery is another matter, dealt with further below.

Second, in principle, the mechanism is not limited to instruments payable to the bearer. Nor does it necessarily cover all instruments payable to bearer. Indeed, the *ruq'a* and *sakk* are payable to the bearer, while the *suftaj* is typically payable to a named payee. However, while the former are transferable by delivery and the latter is not, there is no indication that this is a matter of legal doctrine relating to the identification of the payee, rather than a matter of practice differentiating between types of instruments. Stated otherwise, under non-Hanafi rules, there is nothing to preclude the transfer of an instrument payable to a named payee by its mere delivery (plus an agreement); no predecessor for an endorsement in the form of a signature by the transferor is to be found in Islamic legal doctrine.<sup>128</sup> Under this reasoning, as will be explained further below,<sup>129</sup> the non-transferability of the *suftaj* is a matter of practice relating to the function of the *suftaj* and not to its being an instrument payable to a named payee; a *suftaj* payable to bearer is thus equally not transferable.

Third, there is no indication as to the ability of a transferee of an instrument transferable by delivery to obtain a good indefeasible title to it. The entitlement of the person to whom the instrument is issued as well as of any subsequent transferee is explained under the principles governing the *hawale*. Hence, instruments transferable by delivery were not 'negotiable' in the full sense of the term.

Thus, in the final analysis, under non-Hanafi rules, by reference to the mutual assent of the debtor and creditor, transferability by delivery of a debt instrument, creates a *hawale*; that is, it 'turns' the paymaster's obligation away from

<sup>126</sup> See eg, in England, *Bills of Exchange Act*, 1882 (UK), 45 & 46 Vict., c. 61.

<sup>127</sup> For the definition of 'negotiable instrument' as a document of title to a sum of money, transferable by delivery (plus an endorsement as may be necessary) so as possibly to give the transferee a complete title, better than that of the transferor, to the document and the rights embodied therein, see DV Cowen and L Gering, *Cowen on the Law of Negotiable Instruments in South Africa*, 5th edn vol I: General Principles (Cape Town: Juta, 1985) at 52.

<sup>128</sup> For the inaccurate use of 'endorsement' in relation to the *suftaj*, see n 226 below.

<sup>129</sup> See text and nn 202–06 below.

the debtor onto the creditor. In the process, it facilitates the circulation of the aforesaid debt instrument, and yet falls short of its negotiation.

### 3.2 The *Suftaj* Under *Hawale* Principles

This subsection deals with the formation of the bilateral *hawale* agreement underlying the operation of the *suftaj* and facilitating under the various Islamic schools the conferment of an entitlement on the creditor. It further discusses the function of the *suftaj*. Ensuing subsections deal with (a) the nature of the paymaster's payment obligation on a *suftaj*, and his position towards a correspondent that may be nominated to pay in the designated place of payment; (b) the transferability under a *suftaj*, from the debtor to the paymaster, of the debt obligation owed (originally by the debtor) to the creditor, (c) the non-transferability of the *suftaj*, namely, of the paymaster's obligation, to the creditor's own creditor (as well as onward), and finally, (d) the objections in Islamic legal doctrine to the very function of the *suftaj* to transmit payment from one place to another.

Islamic contract theory emphasizes mutual consent; to that end, Islamic law 'does not choose the avenue of formality, beyond requiring that words be exchanged that convey, explicitly or implicitly, an unambiguous offer . . . and acceptance'.<sup>130</sup> In applying this principle, the most restrictive school of law is Shafi'i, which requires mutual assent to be orally expressed in clearly spoken words.<sup>131</sup> At the same time, as long as assent is unambiguously expressed, the other schools are satisfied with both written and oral contracts, agreed explicitly or implicitly. For all schools, it is normally required that the offer and acceptance are to be exchanged between the parties in the same meeting or session; stated otherwise, both are usually expected to be present together at the time the contract is concluded.<sup>132</sup> However, nothing precludes a contract from being

<sup>130</sup> FE Vogel, 'Contract Law of Islam and the Arab Middle East' in A Von Mehren (chief ed), *Contracts in General*, vol VII of U Drobnič and K Zweigert (responsible eds), *International Encyclopedia of Comparative Law* (Tübingen: JCB Mohr, 2006) ch 7 at 44. See also GH Bousquet, *Précis de Droit Musulman* principalement malékite et algérien, 2nd edn, rev 3rd edn du Précis élémentaire (Alger: La Maison des Livres, 1950) at 256. In detail for the expression of consent in Islamic law, see Y Linant de Bellefonds, *Traité de Droit Musulman Comparé* vol I: Théorie Générale de l'Acte Juridique (Paris: Mouton & Co, 1965) at 116–56 and MA Hāmid, 'Mutual Assent in the Formation of Contracts in Islamic Law' (1977), 7 *Journal of Islamic and Comparative Law* 41. The various elements of 'consent', though technically only in connection with a contract for sale, are also discussed by Rayner, above n 121 at 105–21.

<sup>131</sup> Linant de Bellefonds, *ibid* at 136–37; and Vogel, *ibid* at 32 and 44.

<sup>132</sup> See eg Schacht, *Introduction*, above n 21 at 145, according to whom, in Islamic law, 'The contract is a bilateral transaction, and it requires an offer . . . and an acceptance. . . , both made normally in the same meeting . . . of the contracting parties.' Other than under the Maliki school (Linant de Bellefonds, *ibid* at 155), an offer may be withdrawn until accepted (Schacht, *ibid*); according to one view, both offer and acceptance can respectively be withdrawn as long as the contractual session has not been terminated. See Coulson, above n 1 at 46, Vogel, *ibid* at 44. For the contractual session see also Chehata, above n 21 at 117–18.

reached between distant parties on the basis of an exchange of unambiguous messages between them, and the use of messengers to convey such messages. Messages exchanged between parties who are away from each other may be oral; other than under Shafi'i law, messages could also be communicated exclusively in writing.<sup>133</sup>

According to Ray, in contrast to their Hanafi counterparts, Maliki rules<sup>134</sup> facilitate the use of a *hawale* to transmit funds from place to place. As he explains, under Maliki law, a debtor owed by a paymaster who is situated in one place and who wishes to pay a creditor located in another place, 'can transmit [the paymaster's] recognisance of debt to [the creditor]', thereby causing the paymaster to become liable to the creditor. However, this does not work under Hanafi law which requires the presence of the paymaster.<sup>135</sup>

Indeed, for a *hawale* to work, Hanafi law requires the paymaster's agreement: such an agreement may be expressed orally, and according to one view, may even be derived from the paymaster's silence.<sup>136</sup> At the same time, other than under Hanafi law, an agreement reached between the debtor and creditor suffices to establish a *hawale*.<sup>137</sup> However, under the non-Hanafi schools, the formation of a *hawale* by means of the delivery by the debtor to the creditor of the paymaster's acknowledgement of debt owed by the paymaster to the debtor, as claimed by Ray, requires some analysis. As explained immediately below, the delivery by the debtor to the creditor of the paymaster's acknowledgement of debt is not a unilateral contract; nor, as was already noted, is it a 'negotiation' constituting a transfer of a debt by the mere physical delivery of the debt document. Rather, it can lead to a bilateral contract to be created by the exchange of an offer and acceptance.

First, the *hawale* is not a unilateral contract. Indeed, it is true that in principle, both the discharge of a debtor<sup>138</sup> and the acknowledgement of a debt<sup>139</sup> may operate as unilateral contracts.<sup>140</sup> As such they may be created by the mere transmittal or delivery of a document by one party to another; it is however the creditor who is to transmit a discharge and the debtor who is to transmit an acknowledgement. *Hawale* based on the delivery of an acknowledgment results in the discharge of

<sup>133</sup> In general, rules that govern the 'contractual session' apply with the necessary modifications to the case where the parties are not present together. See Linant de Bellefonds, *ibid.* at 154–55.

<sup>134</sup> In fact this would be the case for all other, namely, non-Hanafi schools.

<sup>135</sup> Ray, above n 34 at 62.

<sup>136</sup> MD Santillana, *Code Civil et Commercial Tunisien* avant-projet discuté et adopté (Tunis: Imprimerie Générale, 1899), note on art 2011 at 704.

<sup>137</sup> For the differences among the various schools, particularly between Hanafi and non-Hanafi law, see section 2.2 above.

<sup>138</sup> For the acquittal of a debtor as a 'unilateral disposition . . . with immediate legal effect' see Schacht, *Introduction*, above n 21 at 145.

<sup>139</sup> For the 'acknowledgement' as a unilateral 'disadvantageous transaction' see Schacht, *ibid.* at 151, and also at 144.

<sup>140</sup> But cf Linant de Bellefonds above n 130 at 166–68, particularly questioning whether the remittance or cancellation of a debt ('*remise de dette*') does not require the acceptance by the debtor.

the debtor;<sup>141</sup> nevertheless, in a *hawale*, it is the debtor who delivers the document to the creditor rather than the other way around. This cannot operate as a discharge for the debtor. As well, while the transmittal of the document by the debtor results in the discharge of the paymaster towards the debtor, it further results in positioning the paymaster as owing to the creditor; to speak of the *hawale* as resulting in the paymaster's discharge is thus an incomplete, and hence, inadvertently potentially misleading, description of its features. Moreover, the acknowledgement the debtor delivers to the creditor is not of a debt owed by the debtor to the creditor, confirming the debtor's liability to the creditor; rather, it is an acknowledgement by the paymaster of a debt owed by the paymaster to the debtor, which is said to create a debt owed by the paymaster to the creditor (and discharging the debtor on his debt to the creditor). For all these reasons, the *hawale* cannot be rationalized as a unilateral contract.

Second, the *hawale* is not created by 'negotiation'. As indicated,<sup>142</sup> it is certainly premature to view the paymaster's debt document as endowed with the attributes of negotiability. Treating the mere physical transfer of the document as adequate to transfer the debt claim would be to confer on the debt instrument an important attribute of negotiability. Effectively viewing the delivery of the debt document as 'negotiation' thus strikes me as anachronism, inappropriate in terms of contemporary legal doctrine.

At the same time, in the footsteps of Ray,<sup>143</sup> I see how the transmittal by the debtor to the creditor of the paymaster's recognizance of debt may lead to the formation of a *hawale*. However, in my view, it is not the delivery on its own which unilaterally creates the contract. Rather, as indicated, a bilateral contract is created upon the creditor's acceptance of the debtor's offer embodied in the debtor's message which accompanies the paymaster's debt document. Such acceptance is to be manifested but not necessarily communicated, and certainly not to the debtor himself; indeed, 'The necessity for the communication of the offer and the acceptance appears to have played a very little part in the Islamic law scheme of contracting.'<sup>144</sup> What is required is the expression of mutual assent, and not necessarily its communication; it is enough for the parties to express their assent in the presence of each other at the meeting place.<sup>145</sup> Hence, there is no difficulty in finding mutual assent where delivery of the debt document occurs face-to-face. By the same token, in the case of a contract between distant parties, the offeror's messenger is to be treated as 'a conduit pipe for conveying the words of the offeror',<sup>146</sup> in which case, suffice it for the offeree's acceptance to be manifested at the meeting place between the offeror's messenger and the offeree.

<sup>141</sup> Cf Schacht, *Introduction*, above n 21 at 148 who speaks of the *hawale* as a 'way of extinguishing an obligation . . . by transforming it into a new one'.

<sup>142</sup> See discussion at the end of section 3.1 above.

<sup>143</sup> Above, text that follows n 137.

<sup>144</sup> Hāmid, above n 130 at 47.

<sup>145</sup> This is a principal theme throughout Hāmid's article, *ibid*.

<sup>146</sup> *Ibid* at 51.



Thus, 'the rule in all schools' appears to be that 'when the parties are contracting *inter absentes*, the acceptance need not be communicated. The contract is complete as soon as the offeree declares his acceptance.'<sup>147</sup> In principle, other than under Shafi'i law, the creditor's acceptance may be manifested by his mere silence in receiving the paymaster's debt recognizance,<sup>148</sup> that is, by not rejecting it within a reasonable time after receipt.<sup>149</sup> In the final analysis however, under non-Hanafi law, the exchange of messages between the debtor and creditor may evolve around the delivery by the debtor of the paymaster's debt document followed by the expression of its acceptance by the creditor; it is this chain of events which creates the *hawale* as a bilateral contract between the debtor and creditor.

Indeed, as a matter of Islamic legal doctrine, under non-Hanafi law, an agreement reached between the debtor and the creditor is effective to compel the paymaster to pay the creditor rather than the debtor. As already indicated, the theory behind this rule is the indifference of the paymaster as to the identity of the payee who is to discharge him on his payment obligation.<sup>150</sup> This rationale set the limits of the rule; the debtor-creditor agreement is obviously ineffective to modify otherwise the terms of the paymaster's payment obligation. In our context, such an agreement to which the paymaster is not a party is incapable of requiring him to change the place of payment,<sup>151</sup> and thereby effectively assume the risk of carrying the money from the debtor's location to that of the creditor.

Accordingly, under non-Hanafi law, the paymaster's consent can be bypassed only where, as a result of the *hawale*, the paymaster is to pay the creditor at the location originally designated for payment for the paymaster's obligation to the debtor. This means that even under non-Hanafi law a creditor located in a place<sup>152</sup> different from that of the debtor will benefit from a *hawale* agreed to without the consent of the paymaster only under narrow circumstances. A case in point is where, as a result of the *hawale*, the paymaster who originally agreed to pay the debtor at the debtor's place is to pay at the same place to an agent duly appointed by the creditor.<sup>153</sup> Another case is that where the paymaster originally agreed with the debtor to pay at the creditor's location.<sup>154</sup> Per the *hawale*, the risk of money-transport remains with the creditor in the former case; it is

<sup>147</sup> *Ibid* at 52.

<sup>148</sup> For expression of consent by silence see Linant de Bellefonds above n 130 at 141–45.

<sup>149</sup> For the reasonable time available for acceptance by the recipient of a message containing an offer see Linant de Bellefonds *ibid* at 155.

<sup>150</sup> See text that follows paragraph containing nn 40–41 above.

<sup>151</sup> Discussion does not deal with *de minimis* changes that are unlikely to change risk materially; rather, it assumes significant change of location.

<sup>152</sup> As immediately above, 'different' or 'designated' (as well as 'same') 'location' or 'place' is broadly used by reference to a 'city', or any other venue which respectively does or does not materially change the risk assumed by the paymaster in the payment obligation he incurred to the debtor.

<sup>153</sup> More broadly, such a case is whenever payment is to be made at a place other than of the creditor; it would not matter if it is the debtor's place or anywhere else.

<sup>154</sup> A similar case will be where the paymaster, who is also in business in the creditor's location, agreed to pay wherever a proper demand is presented to him.

left with the debtor in the latter. Either way, the risk incurred by the paymaster has not been altered; in the former case, he is still to pay at the debtor's place while in the latter case he is still to pay at the creditor's place.

In the final analysis, to require the paymaster to pay the creditor in a place different from the one designated in the paymaster's contract with the debtor, the paymaster's agreement or consent is required under both Hanafi and non-Hanafi law. Under Hanafi law, the paymaster's agreement is required to effect the *hawale*; under the other schools, the paymaster's consent is required to effect a modification in the terms of his original payment obligation. It is only where there is no change in the place in which the paymaster is to pay, that is, where no modification in the terms of his original payment obligation is involved, that non-Hanafi rules do not require an additional agreement by the paymaster and hence benefit the creditor more than Hanafi law.

Thus, under non-Hanafi law, the paymaster's consent in his original agreement with the debtor can benefit the creditor who has concluded the *hawale* agreement with the debtor. At the same time, under Hanafi law, a creditor wishing to enforce the paymaster's payment undertaking contained in the paymaster's agreement with the debtor, must subsequently reach a separate agreement with the paymaster, even where the terms of that agreement are identical to those of the earlier agreement between the paymaster and the debtor. This is so since under Hanafi law, the *hawale*, without which the creditor is not entitled to receive payment from the paymaster, is to be formed by an agreement reached between the paymaster and the creditor.

In sum, the paymaster's engagement under his contract with the debtor to pay him in a place other than that of the debtor can be transferred and become owed to a creditor located in the designated place of payment. This may be accomplished according to all schools, by means of a *hawale*; the *hawale* requires an additional, in fact confirming, agreement of the paymaster, under Hanafi rules, but not otherwise. It is from this perspective that the use of *hawale* to transmit payment between a distant debtor and creditor is more practical under non-Hanafi law.<sup>155</sup>

Certainly, this distinction between the Hanafi and the other laws is important in an environment in which documents of debts circulate, namely, are intended to pass freely from the hands of the creditor to a transferee, and onwards to an indefinite chain of subsequent transferees. In such an environment, seeking the paymaster's consent each time, as required under Hanafi law and dispensed with by the other rites, is inefficient and, depending on the circumstances of a given case, may become an obstacle. However, the significance of that distinction is not to be overstated in an environment which does not purport to facilitate the movement of a debt document beyond the hands of the original

<sup>155</sup> With respect, this limitation, to the case in which the paymaster's engagement under his contract with the debtor is to pay him in a place other than that of the debtor, seems to be overlooked by Ray, above n 34 at 65, who notes that the use of a *hawale* to transmit payment between a distant debtor and creditor is more practical under non-Hanafi law.

creditor; a paymaster who agreed with the debtor to pay in a place other than that of the debtor may anyway be easily disposed to reconfirm his agreement to the creditor, as required under Hanafi law and dispensed with under the other schools. The crucial step is the initial agreement to pay other than at the debtor's place, a step that as indicated is by no means bypassed in non-Hanafi law.

A paymaster is likely to agree to pay other than at the debtor's place where the paymaster's debt arises in the first place with the view to transmit payment from place to place, whether as a primary objective or an incidental feature of the transaction. To that end the *suftaj* developed to achieve the binding agreement of the paymaster to pay in a location other than that of the transaction that gave rise to the paymaster's obligation to the debtor. Indeed, in a *hawale*, the paymaster may be, and other than under Hanafi law, must be, indebted to the debtor; the debt thus owed by the paymaster is pre-existing, and has not been created as a part of the *hawale* transaction. At the same time, in a *suftaj*, the paymaster must owe money to the debtor; such debt is however owed under a transaction created under the *suftaj* transaction, specifically with the view of making repayment elsewhere.<sup>156</sup> The delivery of money to the paymaster with the view of transmitting its sum to another destination is often referred to as 'remittance', in which case, the person delivering the money to the paymaster is the 'remitter'.

Repayment by the paymaster of the sum received under the *suftaj* is to be made in a place designated under the *suftaj* which is different from the place where the paymaster received the equivalent sum of money. As provided in the *suftaj*, repayment may be to the remitter, who delivered the money to the paymaster (and thus became his creditor). Alternatively, repayment by the paymaster may be stated to be made in the designated place to another person nominated by the remitter. Thus, the *suftaj* does not necessarily entail the transfer of the obligation to pay so as to invoke *hawale* principles. Stated otherwise, the distinctive feature of the *suftaj* is the repayment of a debt in a place other than of the original debt transaction, and not necessarily to a different party.

Where the designated payee is the remitter himself the *suftaj* serves as an equivalent of the modern traveller's cheque<sup>157</sup> or its predecessor, the traveller's letter of credit;<sup>158</sup> thereunder, a traveller forgoes the risk of carrying cash with him by delivering money to a paymaster at the place where the travel commences and arranging (with the paymaster) to have the equivalent sum made available to him (the remitter/traveller) at the place of destination.

At the same time, a payee other than the remitter may be a donee or a creditor of the remitter. A *suftaj* payable to a person other than the remitter is thus the

<sup>156</sup> See eg Schacht, *Introduction*, above n 21 at 149.

<sup>157</sup> For the traveller's cheque see eg HG Beale (general ed), *Chitty on Contracts*, 29th edn vol II: Specific Contracts (London: Sweet & Maxwell, 2004) at paras 34-174–34-185, pp 333–38.

<sup>158</sup> Traveller's letter of credit is defined eg in BA Garner (ed in chief), *Black's Law Dictionary*, 9th edn (St Paul, Minn: Thomson West, 2009) at 988. Such letters of credit are 'in the nature of traveler's checks.' See JF Dolan, *The Law of Letters of Credit*, 4th edn (Austin, TX: Pratt, 2007) at para 3.02, pp 3–6, fn28.

forerunner of the commercial bill of exchange, with which the remitter is to pay his debt to a distant creditor without physically carrying the money from place to place.<sup>159</sup> A *suftaj* payable to a person other than the remitter may also be used to fulfil a function of the modern commercial letter of credit, under which a designated payee would not release goods to be sold to the remitter other than against the paymaster's obligation to pay for them.<sup>160</sup>

Certainly, the *suftaj* payable to a payee other than the remitter falls short of fulfilling all the functions of its above-mentioned successors. Particularly, unlike the early Medieval Continental bill of exchange, the *suftaj* is payable in the same currency as the one given by the remitter to the paymaster;<sup>161</sup> it involves no currency exchange element.<sup>162</sup> As well, unlike the documentary letter of credit, the *suftaj* provides no protection to the remitter; it anticipates payment on the payee's demand with no mechanism to ensure that he fulfilled his part of the contract.<sup>163</sup> As such, the *suftaj* payable to a payee designated by the remitter is a payment mechanism pure and simple, used for payment between distant parties, usually, a debtor and creditor. Being unconditionally payable upon presentment, it is thus more akin to the bill of exchange than to the commercial letter of credit.<sup>164</sup>

### 3.3 The Legal Nature and Operation of the *Suftaj*

The analysis of the legal nature of the *suftaj* is designed to provide answers to three key questions. The first is the nature of the paymaster's obligation and his position towards a correspondent that may be nominated to pay in the designated place of payment. This question comes up whether or not this obligation is stated to be payable to the remitter or to a payee designated by him. With regard to a *suftaj* payable to a payee other than the remitter, a second question arises, that is, as to the redirection of the paymaster's obligation from being owed to the remitter to being owed to the payee. Finally, the third question is as to the non-transferability of the *suftaj*.

<sup>159</sup> For the modern bill of exchange, see n 115 above.

<sup>160</sup> For the modern letter of credit, see n 116 above.

<sup>161</sup> In contrast, currency exchange was at the heart of the early bill of exchange transaction in Continental Europe. See eg MT Boyer-Xambeu, G Deleplace and L Gillard, *Private Money & Public Currencies – The 16th Century Challenge*, trans by A Azodi (Armonk NY and London, England: ME Shape, 1994) at 25–35. See discussion in ch 8, section 3 below.

<sup>162</sup> Ashtor, above n 102 at 562–65 enumerates three grounds on which the *suftaj* is distinguished from the bill of exchange: currency, number of participants, and availability of endorsements. Among these three points, the second is dubious. As for lack of endorsements, see text and nn 126–29 above, as well as text and nn 202–06 and 226 below.

<sup>163</sup> In contrast, the commercial letter of credit requires payment to the beneficiary (creditor) only against documents strictly complying with specifications laid out by the applicant (debtor). The classic authority on this point is *JH Rayner v Hambro's Bank* [1943] K.B. 37 at 40.

<sup>164</sup> For the bill of exchange in modern law, as an unconditional order of payment, payable upon the (usually) physical presentation of the instrument, see eg the English *Bills of Exchange Act, 1882* (UK), 45 & 46 Vict., c. 61, s. 3(1) in conjunction with ss 45 and 52(4).

So far as the first question is concerned, the paymaster's obligation is classified under Islamic law as that of a borrower; that is, under all schools of Islamic law, the *suftaj* gives rise to a loan repayable in a place different from that of the loan.<sup>165</sup> The loan is constituted by the delivery of the money by the remitter to the paymaster who agrees to repay an equivalent sum in the same currency, at the designated location, to the designated person, the latter being the remitter himself or someone nominated by him. The paymaster expresses his agreement by placing his signature on the *suftaj* document.

The *suftaj* is thus a document reflecting a borrower's undertaking to repay a monetary loan in the currency of the loan,<sup>166</sup> to a payee usually identified in the document, and who is to present it and obtain payment in a designated place other than the place of the loan. The designated payee could either be the original lender or his nominee. A designated nominee could well be the lender's own creditor. In the scenario on which the present discussion focuses, the debtor (in the transaction to be paid by *suftaj*) is the lender (to whom the *suftaj* is issued), the paymaster (*suftaj* issuer) is the borrower, and the designated payee is the creditor (in the transaction to be paid by *suftaj*); the debtor 'lends' the paymaster money to be repaid by the paymaster ('borrower') to the creditor in discharge not only of the 'loan' made to the paymaster by the debtor, but also of a debt owed by the debtor to the creditor, and incurred prior to and irrespective of, the *suftaj*.

As a rule, a *suftaj* was issued by a paymaster of high repute;<sup>167</sup> it entailed a high commission<sup>168</sup> and was hard to get.<sup>169</sup> The operation of the *suftaj* system is premised on the presence of the paymaster or his correspondent in each of the places, that of the debtor and that of the creditor.<sup>170</sup> That is, the paymaster may be a large merchant who operates in both places. He takes the money in one place and returns an equivalent sum in another without physically carrying it from place to place. In other words, he uses the borrowed money at the place of

<sup>165</sup> See eg Schacht, *Introduction*, above n 21 at 149, defining the *suftaj* as 'a loan of money in order to avoid the risk of transport.' See further, section 3.4 below.

<sup>166</sup> I suppose that the identity between the currency of the loan and of its repayment was a matter of practice rather than a requirement derived from any legal doctrine.

<sup>167</sup> The point is highlighted by Goitein above n 104 at 242–43, who goes on to say that otherwise, in the *Geniza* documents, 'Payment though a third party in another city fell under the general category of transfer of debt' and was not treated as a *suftaj*. However, for the purpose of our discussion, no such distinction is to be made.

<sup>168</sup> For questioning the conformity of the practice with the prohibition to take interest see Ray, above n 34 at 77. Regardless, presumably, the commission was waived for small amounts sent for charity. See Goitein, *ibid* at 244.

<sup>169</sup> A fact that contributed to the continued parallel practice of sending purses of money from place to place. See eg Goitein, *ibid* at 244.

<sup>170</sup> Ashtor, above n 102 at 556, 563, and 566 points out that most documentation refers to the *suftaj* as a three-party arrangement. Yet it is not always clear whether the party to be deleted is the creditor (in which case the *suftaj* is payable to the debtor) or the correspondent (in which case it is payable to the creditor by the paymaster). In fact, there is nothing to preclude the possibility of a two-party *suftaj* payable by the paymaster to the debtor, obviously at a place other than where the money was 'lent' by the latter to the former.

the loan, and repays it out of money available to him at the place of the repayment. He may act as a single intermediary in an operation which may thus be a tripartite arrangement.

Alternatively, the paymaster, located at the place of the loan, may employ an agent or business associate, such as another merchant with whom he has ongoing dealings, as a correspondent, who is to make the payment to the payee, at the designated place of payment. In the absence of an institutionalized mechanism for settlement between the paymaster and his correspondent, they are to settle in the course of a mutual business relationship, giving rise to reciprocal debts, created not necessarily exclusively from the transmission of payments for third parties.<sup>171</sup>

It has been attempted to explain legal relations under the *suftaj* in the framework of the *qirād*. The *qirād* is a Maliki term for a bilateral arrangement under which one party (owner or *mālik*) invests capital and another (*āmil*) manages or trades with it on the understanding that they share the profit, but not the loss; rather, any loss resulting from a normal activity is borne by the owner.<sup>172</sup> Unfortunately however, as will be seen immediately below, as a framework of enhancing the understanding of the *suftaj*, *qirād* analysis has been confusing and not particularly helpful.

Thus, the Hedyā discusses the situation in which the managing partner (*āmil*) in a *qirād* becomes liable on a *suftaj* he issues to a third party outside of the *qirād* venture.<sup>173</sup> In such a case the investing partner (*mālik*) is said to become jointly liable with the managing partner (*āmil*) to the third party for the amount

<sup>171</sup> Generally speaking, in this respect, the financial system in the Islamic lands did not go further than its predecessors in Ancient Greece (See: R Bogaert, *Banques et Banquiers dans les Cités Grecques* (Leyde: AW Sijthoff, 1968) at 344–45, 413), Ancient Rome (See: J Andreau, *Banking and Business in the Roman World*, trans by J Lloyd (Cambridge: Cambridge University Press, 1999) at 43, notwithstanding Maxwell, above n 65 at 111 to the contrary) as well as Greco-Roman Egypt (See: R Bogaert, 'Les Opérations des Banques de l'Égypte Ptolémaïque' (1998), 29 *Ancient Society* 49 at 135), none of which institutionalized any mechanism for the multilateral clearing and settlement; the latter is traced to twelfth-century medieval fairs in Europe. See P Huvelin, *Essai Historique sur le Droit des Marchés et des Foires* (Paris: Arthur Rousseau, 1897) at 534, 552–77. For Ancient Greece, Ancient Rome, and Greco-Roman Egypt see in this book ch 3, sections 3, 4, and 5, respectively.

<sup>172</sup> See eg definition by AL Udovitch, 'Credit as a Means of Investment in Medieval Islamic Trade' (1967), 87 *Journal of American Oriental Society* 260 at 261, fn 12 (hereafter: Udovitch, Credit). In fact, *qirād*, or its equivalent, *muqārada* is used by both the Maliki and Shafi'i schools. In Hanafi terminology this arrangement is called *mudāraba*. *Ibid*. Briefly, the *qirād* works as follows: suppose the investor provides the managing partner with \$100 capital. Where the latter works it to produce \$20 profit, this profit is shared between the parties (in an agreed upon ratio) and the \$100 investment is returned to the investor. Conversely, where as a result of normal trading by the managing partner the capital shrank to \$80, the investor takes back this amount (so that the entire financial loss falls on him); the managing partner's loss is limited to his wasted time and effort. The *qirād* is said to be the forerunner of the Medieval European *commenda*. See AL Udovitch, 'At the Origins of the Western Commenda: Islam, Israel, Byzantium?' (1962), 37(2) *Speculum* 198, particularly at 207 (hereafter: Udovitch, 'Commenda').

<sup>173</sup> Hedyā, above n 28 at 466, discussing the *mozaribat*, defined at 454 in terms of a *qirād*.

'borrowed' under the *suftaj* only upon ratification by the investing partner.<sup>174</sup> Grasshoff discusses this Hedya text.<sup>175</sup> Huvelin understands Grasshoff to analyse the *qirâd* as governing the relationship in a *suftaj* between the paymaster and his correspondent where they have an ongoing business relationship.<sup>176</sup> Huvelin draws from the application of this *qirâd* framework to the *suftaj* two implications. First, in his view, the *qirâd* relationship explains the liability of the correspondent to the paymaster.<sup>177</sup> Second, according to him, the *qirâd* relationship explains the joint liability of the paymaster and his correspondent to the third-party creditor, and hence the recourse of the third-party creditor against the paymaster in case of non-payment by the correspondent.<sup>178</sup>

Elsewhere, Grasshoff speaks of a situation in which the investing partner (*mâlik*) in a *qirâd* requests the managing partner (*âmil*) to return the invested capital plus his (the investing partner's) share in the profit to another location by means of a *suftaj*.<sup>179</sup> In such a case, the *qirâd mâlik* is the *suftaj* lender (that is, the debtor in our generic paradigm), while the *qirâd âmil* is the *suftaj* paymaster (that is, the borrower under the *suftaj* and its issuer). Remde may have understood Grasshoff to say that under such circumstances the risk under the *suftaj* is allocated by the law applicable to a *qirâd*.<sup>180</sup> Remde thus appears to interpret Grasshoff as arguing that the *qirâd* relationship continues to govern the *suftaj*.<sup>181</sup> Under this interpretation, per rules applicable to the *qirâd*, the risk of

<sup>174</sup> For the amount borrowed on the *suftaj* the two *qirâd* partners become parties to a credit partnership (*sharikat al-wujûh*), and thus jointly liable. *Ibid.* According to Udovitch, 'Credit partnership (*sharikat al-wujûh*) . . . is simply an arrangement in which the capital of the parties consists not of their own cash or merchandise, but of credit either in the form of a loan or of purchases of goods for which payment was deferred.' AL Udovitch, 'Theory and Practice of Islamic Law: Some Evidence from the Geniza' (1970), 32 *Studia Islamica* 289 at 299–300 (hereafter: Udovitch, 'Theory'). The '*sharikat al-wujûh*' was also known as 'the partnership of those with good reputations', in which the partners invested in credit. See Udovitch, 'Credit', above n 172 at 262. Between the partners, both liability and profit must correspond to the investment.

<sup>175</sup> R Grasshoff, *Das Wechsel Recht der Araber* (Berlin: Verlag von Otto Liebman, 1899) at 24–25 [in German, I relied on an unofficial translation]. It should be noted that the Hedya, *ibid* appears to speak of two alternative scenarios; one of giving and the other of taking the *suftaj* by the managing party. This ambiguity reappears in Grasshoff's passage, *ibid* as well. On his own, Grasshoff can thus be alternatively understood to say that an *âmil* under a *qirâd* who outside the *qirâd* venture lends and takes a *suftaj* from a third party paymaster cannot bind the *mâlik* who is to become bound and thus effectively liable to the *âmil* jointly with the third party paymaster (*suftaj* issuer) only upon the *mâlik*'s ratification. In any event, the Hedya, *ibid* (on which Grasshoff relies) specifically speaks of a *sharikat al-wujûh* between the *âmil*/paymaster and the *mâlik* which excludes this alternative understanding from Grasshoff.

<sup>176</sup> Huvelin, 'Travaux', above n 5 at 23–24. And yet, in the footsteps of the Hedya, Grasshoff does not even treat the correspondent as a party to the *qirâd* arrangement. *Ibid.*

<sup>177</sup> *Ibid.*

<sup>178</sup> *Ibid.*

<sup>179</sup> Grasshoff, above n 175 at 29.

<sup>180</sup> A Remde, *Lettera di Cambio und Suftadja Eine Rechtsvergleichende Studie als Beitrag zur Entstehungsgeschichte des Wechsels* (Köln: Inaugural-Dissertation, 1969) at 88 [in German, I relied on an unofficial translation].

<sup>181</sup> Unfortunately, he is quite vague on this point. He is saying, however, that '[w]ere the *qirâd* to be regarded as the cause [of the *suftaj*], then the *âmil* must be the issuer of the *suftadja* and the issuance of the *suftadja* occurs against the commitment of the *qirâd*'. *Ibid* at 88. The interpretation proposed in the text above is consistent with Remde's ensuing critique.



loss of the *suftaj* money falls on the *suftaj* lender (the debtor in our generic paradigm), acting as the *qirâd mâlik*, the party who used the *suftaj* in the first place to avoid that risk.

Charging the *suftaj* lender (that is, the debtor in our generic paradigm) with the risk of loss, per Remde's interpretation of Grasshoff, is obviously contrary to principle. Thus, disagreeing with what he appears to understand Grasshoff to say, Remde suggests that in the course of the transmission of funds under a *suftaj* a *qirâd* could nevertheless be constructed, and yet, only between the paymaster and his correspondent;<sup>182</sup> he thus assigns the role of the *qirâd* investor (*mâlik*) to the paymaster, who is indeed to bear the loss by reimbursing his *qirâd* managing partner (*âmil*), the *suftaj* correspondent.<sup>183</sup> From this perspective, the added value of the *qirâd* analysis to our understanding of the *suftaj* is however, rather limited; it only strengthens the correspondent's claim for recourse against the paymaster. As well, possibly,<sup>184</sup> under non-Hanafi rules, recourse of the correspondent against the paymaster on a *qirâd* provides a legal basis for the operation of the *suftaj* even where the paymaster does not owe in advance to the correspondent,<sup>185</sup> other than as the *qirâd* investor.

It seems to me that both Huvelin and Remde read too much into Grasshoff and thus misinterpret him; I do not read Grasshoff to analyse any aspect of the *suftaj* as a *qirâd* relationship; rather, he only deals with the *suftaj* in two separate situations in which a *qirâd* pre-exists the *suftaj*. In the first case he deals with the liability of the investing party for the amount of a *suftaj* issued by his managing partner outside the *qirâd* venture. In the second case he discusses the use of the *suftaj* to transfer the *qirâd* investment and profit share of the investing partner to another location. In the former case the ratifying *mâlik* becomes liable under the law applicable to *qirâd*; in the latter, the relationship under a *suftaj* issued by the *âmil* to the *mâlik* is nevertheless governed by the law applicable to *suftaj*; being the *suftaj* issuer, it is thus the *âmil* who bears the risk of loss of the *suftaj* money. This is exactly as if the *suftaj* issuer were a stranger to whom the *qirâd* investor (*mâlik*) gave the money, he had just received from the *qirâd âmil* at the termination of the *qirâd*, for transmission from the *âmil*'s place to that of the *mâlik*. In both cases, the one put forward by the Hedy and discussed by Grasshoff as well as the one put forward by Grasshoff, the law of *qirâd* is not superimposed on and does not supersede the law of *suftaj*.

<sup>182</sup> Remde is unclear as to whether his analysis is limited to the case of a *suftaj* issued by an *âmil* to transmit payment owed to an investor (*mâlik*) under a *qirâd*. If so, Remde is to be understood as saying that the *âmil* in the *qirâd* whose principal amount and (investor's) share in profit is to be transmitted by means of a *suftaj*, becomes the *mâlik* in the *qirâd* under which the *suftaj* is carried out.

<sup>183</sup> For the *mâlik*'s obligation to reimburse the *âmil* in a *qirâd* arrangement see text and n 172 above. For the paymaster's obligation to reimburse the correspondent under a *suftaj*, see text and n 171 above.

<sup>184</sup> The hesitation stems from the fact that a *qirâd* appears to require actual advance on the part on the investor/owner (paymaster) (and not merely an undertaking to invest), in which case there is anyway a debt owed to him by the managing partner (correspondent).

<sup>185</sup> For the indebtedness requirement under non-Hanafi rules, see text that follows paragraph containing n 42 above.

A *suftaj* is usually drafted to be payable on demand; it may be properly authenticated so as to be easily provable<sup>186</sup> and may further be drafted to impose heavy penalties for any delay in payment.<sup>187</sup> Payment on a *suftaj*, namely, repayment of the loan that gave rise to it, whether by the paymaster or his correspondent, is typically made against its proper presentment by the payee at the place designated for payment.<sup>188</sup> Thus, a remitter is likely to carry with him a *suftaj* payable to himself and to send the creditor a *suftaj* of which that creditor is the payee. However, the entitlement to enforce the paymaster's obligation on the *suftaj* is not on the basis of possession by the named payee; rather, from a legal perspective, the paymaster-borrower is bound under the *suftaj* to the debtor-lender, even where the repayment obligation is to be discharged by payment to the third-party creditor. The paymaster's engagement on the *suftaj* does not inure to the benefit of the creditor, who thus, as a matter of a strict legal doctrine, is not entitled to enforce it. Rather, the engagement is enforceable exclusively by the debtor ('lender') to whose benefit the paymaster's obligation inures. This takes us to the second aforesaid question<sup>189</sup> relating to the legal underpinning of the *suftaj*, namely, to the redirection of the paymaster's obligation from being owed to the debtor-'lender', to being owed to the payee-creditor.

Indeed, on his part, the creditor may wish to have a direct right against the paymaster: this is particularly so when the creditor obtains the *suftaj* prior to its stated due date,<sup>190</sup> before he is entitled to payment under his contract with the debtor, or else, where he is either prepared to give the paymaster an extension, wishes to be paid on it in instalments,<sup>191</sup> or seeks to enforce payment against the paymaster. To all such ends, the creditor may be given a direct right against the paymaster by means of a *hawale*. Certainly, according to the non-Hanafi schools, a *hawale* may be established without the consent of the paymaster, by the bilateral agreement of the debtor and the creditor. In the footsteps of Ray and as explained above, this can be achieved by the creditor's acceptance from the debtor of the paymaster's recognizance of indebtedness.<sup>192</sup> And yet, as

<sup>186</sup> For the *suftaj* as instrument, see Grasshoff, above n 175 at 30–34.

<sup>187</sup> See eg Udovitch, 'Reflections', above n 113 at 16. Goitein above n 104 at 243 is to the same effect; at 245 he even mentions the possibility of a paymaster making advances on a forthcoming *suftaj* prior to its arrival. For questioning the validity of the penalty clauses as possible violation of the prohibition to take interest, see Ray, above n 34 at 77.

<sup>188</sup> According to Imamuddin, above n 10 at 29, 'Each *suftajah* had its own time limit which was generally forty days'; it must thus be presented prior to expiry date.

<sup>189</sup> For the enumeration of key questions, see above, first paragraph in section 3.3.

<sup>190</sup> For such *suftajs* see eg Ashtor, above n 102 at 557, fn 31. The text on which Ashtor relies is At-Tanūkhī, (1930) 10 *Revue de l'Académie Arabe* [*Majallat al-Majma' al-'Ilmi al-'Arabi*] X, 678 at 680, which is al-Muhassin b Ali al-Tanūkhī, 'Jami' al-Tawarikh [or] Nishwar al-Muhadara wa Akhbar al-Mudhakara' ['The Comprehensive History' or 'Transcripts and Stories of Conversation'] (1930), 10 *Majallat al-Majma' al-'Ilmi al-'Arabi* [Journal of the Arabic Learned Society] 678, 680 [in Arabic]. This is a literary text speaking of a *suftaj* presented on due date, and on which payment was requested to be made in instalments by the beneficiary who presented it. I relied on an unofficial translation.

<sup>191</sup> The practice, noted by Imamuddin, above n 10 at 30 (as well as by At-Tanūkhī, *ibid*), 'is not mentioned in legal works.' Ray, above n 34 at 71.

<sup>192</sup> See text and nn 134–46 above.

explained, for this to work, the paymaster's recognizance of debt must have expressed an obligation to pay other than in a place of the loan, and would thus normally be on a *suftaj*.<sup>193</sup>

At the same time, under Hanafi law, the *hawale*, giving the creditor a direct right against the paymaster on the *suftaj*, requires the agreement of the paymaster, effectively confirming to the creditor, and thus inuring to his benefit, the paymaster's early agreement on the *suftaj*. Indeed, it may be arguable that the transmittal to the creditor of the *suftaj* document with the consent of the paymaster may be viewed as a confirmation to the creditor of the paymaster's undertaking and hence constitutes his agreement with the creditor;<sup>194</sup> but even then the creditor is likely to insist on being presented with tangible evidence as to the paymaster's consent.

In any event, according to all Islamic schools, it is thus the *hawale*, with the full implications and incidents, as discussed in section 2.2 above, that 'perfects' the creditor's right to be paid on the *suftaj*. Accordingly, in the case of default by the paymaster, both major schools, the Hanafi and Maliki, usually do not permit the recourse by the creditor against the debtor; each restricts it only to exceptional cases. As well, under Hanafi rules, the creditor is enforcing against the paymaster the debtor's debt owed to the creditor. On the other hand, under Maliki rules, the creditor is enforcing against the paymaster the paymaster's debt against the debtor. Accordingly, under Hanafi law, when sued by the creditor, the paymaster may raise the debtor's, but not his own, defences. Conversely, under Maliki rules, the paymaster may raise against the creditor his (but not the debtor's) defences.<sup>195</sup>

The picture gets more complex but the analysis does not materially change where the creditor seeks a direct cause of action against the paymaster's correspondent located in the creditor's place. In such a case, two successive *hawales* are required. Under a first *hawale*, the paymaster becomes liable to pay the creditor; this agreement is to be followed by a second *hawale*, under which the paymaster's correspondent becomes liable to pay the creditor.<sup>196</sup> Following the previous discussion, under non-Hanafi law, parties to the first *hawale* agreement are the debtor and the creditor, and parties to the second *hawale* agreement are the paymaster (who replaces the debtor) and the creditor. Under Hanafi law, parties to the first *hawale* are the paymaster and creditor, while parties to the second *hawale* are the correspondent (who replaces the paymaster) and the creditor.

<sup>193</sup> See discussion in text around nn 150–56 above.

<sup>194</sup> Of course, this could work only with the schools that recognize the possibility of an implicit contract, which excludes Shafi'i law which (as indicated in text and n 131 above) requires mutual assent to be orally expressed in clearly spoken words.

<sup>195</sup> In a *suftaj*, the paymaster owes the debtor. As well, neither personal nor proprietary securities are involved. Hence, per discussion at the end of section 2.2 above, these issues, on which the Islamic schools vary, do not arise.

<sup>196</sup> In fact, such a second *hawale* will be required also to benefit the payee where he is the remitter himself.

This 'chain transaction' facilitating the creditor's cause of action against the correspondent works as follows. Under non-Hanafi law, the first *hawale* is established by the creditor's acceptance from the debtor of the *suftaj* document containing the paymaster's engagement. This creates the paymaster's obligation to the creditor. The second *hawale*, generating the correspondent's obligation to the creditor, is formed by the paymaster's transmittal of advice to the creditor. This paymaster's advice may be constituted through the same delivery by the debtor to the creditor of the *suftaj* containing the paymaster's direction to the correspondent to pay the creditor; that is, in authorizing the debtor to send the *suftaj* to the creditor, the paymaster may be seen as authorizing the debtor to convey to the creditor the paymaster's agreement with the creditor. Under non-Hanafi rules, this paymaster's agreement is not needed to support the paymaster's own liability to the creditor; the agreement is however essential to make the correspondent, who is indebted to the paymaster, liable to the creditor instead.<sup>197</sup> Effectively then, in delivering to the creditor a *suftaj* document containing both the paymaster's undertaking and direction to the correspondent, the debtor acts both as a principal (under the first *hawale*) and agent for the paymaster (under the second *hawale*). The ensuing presentation of the *suftaj* by the creditor to the correspondent serves then as a demand for payment rather than a request designed to procure a binding agreement.

In Hanafi law, the first *hawale*, leading to the paymaster's engagement to the creditor, is formed by the paymaster's agreement with the creditor. This agreement is created by the acceptance by the creditor of either the transmittal of confirmation from the paymaster to the creditor, or an authorized undertaking on the paymaster's behalf by the correspondent. As was indicated, arguably, the transmittal to the creditor of the *suftaj* document with the consent of the paymaster may be viewed as a confirmation to the creditor of the paymaster's undertaking and hence constitutes his agreement with the creditor.<sup>198</sup> In turn, the second *hawale*, generating the correspondent's engagement to the creditor, is established under Hanafi law by the correspondent's agreement with the creditor. In practice, the creditor (or his agent) may procure the agreement of the paymaster and/or his correspondent upon presenting the *suftaj* document to the party to be charged with liability.

In the case of default by the correspondent, both major schools, the Hanafi and Maliki, usually do not permit the recourse by the creditor against the debtor or the paymaster;<sup>199</sup> each restricts it only to exceptional cases. As well, under Hanafi rules, the creditor is enforcing against the correspondent the paymaster's debt owed to the creditor; as discussed, under Hanafi rules, this is in fact the

<sup>197</sup> Of course, similarly to the case discussed in text and n 194 above, this could work only with the schools that recognize the possibility of an implicit contract, which excludes Shafi'i law which requires mutual assent to be orally expressed in clearly spoken words.

<sup>198</sup> See text and n 194 above.

<sup>199</sup> As discussed in section 2.2 above, and notwithstanding Huvelin, 'Travaux', above n 5 at 24 to the contrary, who (inexplicably in my view) learns of the creditor's recourse against the paymaster (and *quære* if not also from the debtor) from the correspondent's recourse against the paymaster.

debtor's debt owed to the creditor. On the other hand, under Maliki rules, the creditor is enforcing against the correspondent the correspondent's debt owed to the paymaster. Accordingly, under Hanafi law, when sued by the creditor, the correspondent may raise the debtor's, but not his own, defences. Conversely, under Maliki rules, the correspondent may raise against the creditor his (but neither the debtor's nor the paymaster's) defences.<sup>200</sup>

Certainly, the operation of the *suftaj* appears to be smoother under the non-Hanafi rules, which do not require the correspondent's consent; furthermore, under non-Hanafi law, the paymaster is liable to the creditor without a separate engagement on his part, other than the original one to the debtor. And yet, under the non-Hanafi rules, for the paymaster and the correspondent to be liable to the creditor (respectively under the first and second *hawales*), the paymaster must have owed to the debtor (for the first *hawale* to be effective), and the correspondent must have owed to the paymaster (for the second *hawale* to be effective).<sup>201</sup> The *suftaj* document sent by the debtor to the creditor usually attests to the paymaster's engagement, and hence to the paymaster's debt to the debtor.

Conversely, that document, as well as any other communication that may be involved in the process, is unlikely to incorporate any indication, and certainly not one emanating from the correspondent, as to his liability, not to mention his indebtedness to the paymaster. Surely then, a creditor is likely to seek confirmation as to the correspondent's liability; while, unlike under Hanafi law, a correspondent who is indebted to the paymaster is liable to the creditor even in the absence of a confirmation on his part, the creditor is unlikely to know on his own as to whether the correspondent is in fact indebted to the paymaster. Stated otherwise, in practice, the creditor is likely to seek the correspondent's engagement not only under Hanafi law but also under non-Hanafi rules, except that under the latter, a correspondent indebted to the paymaster is liable to the creditor anyway, even without the knowledge of the creditor.

Finally, there was the third question, relating to the non-transferability of the *suftaj*. It is universally agreed that *suftajs* are not transferred by the creditor,<sup>202</sup> and certainly do not circulate.<sup>203</sup> It seems however that the reason is not doctrinal,<sup>204</sup> but rather practical. Thus, the paymaster's or correspondent's engagement on a *suftaj* is to pay at the creditor's place; it is however possible that in the course of the relevant period there was no commercial need for its use as a local payment mechanism, carrying out payment to a local creditor of

<sup>200</sup> The differences among the various Islamic Schools are set out in section 2.2 above and summarized at its end. See paragraph ending at n 195 above.

<sup>201</sup> For the non-Hanafi law requirement under which the *hawale* transferee (paymaster) is to owe money to the *hawale* transferor (debtor) see text that follows n 42 above.

<sup>202</sup> See text and n 114 above.

<sup>203</sup> Notwithstanding Huvelin, 'Travaux', above n 5 at 24, who must be taken to refer to the transferability and circulation of the *suftaj* as a matter of strict legal doctrine rather than practice.

<sup>204</sup> For transferability and circulation of Islamic payment instruments as a matter of legal doctrine, see section 3.1 above.

the creditor, namely, for its circulation at the designated place of payment. At the same time, as indicated, even non-Hanafi rules do not facilitate the imposition on the paymaster or his correspondent of a duty to pay other than at the agreed place of payment;<sup>205</sup> a *suftaj* could thus not be transferred with the view of carrying out payment from the creditor to his own creditor at another place. Indeed, upon receiving instructions from a creditor who declined to be paid in money, there is nothing to preclude a paymaster or his correspondent from issuing his own *suftaj* payable to the creditor's creditor at a place other than that of the creditor; this however effectuates a new *suftaj*, payable at the place of the creditor's creditor. Where it was available,<sup>206</sup> such a new *suftaj* may have been drawn on a correspondent of the issuer at the latter place, and in any event, cannot be conceptualized as the transfer of the original *suftaj*.

### 3.4 The Objections to the *Suftaj*

As was discussed, as a matter of the application of *hawale* principles, the *suftaj* can be effectuated by all schools; and yet, it has not fared well in Islamic law. Doctrine considers it an abomination founded on a loan conferring profit on the lender. Profit is in the form of 'exempt[ing] the lender from the danger of the road', that is, the avoidance of the risk, and in fact the cost, of physical transport of money from place to place,<sup>207</sup> in violation of the Koranic prohibition against 'acquiring profit upon a loan.'<sup>208</sup> It is stressed that this prohibition applies 'where a person gives something by way of loan, instead of deposit, to a merchant, in order that he may forward it to his friend at a distance',<sup>209</sup> and yet it has not been sought to redefine the delivery of the money to the paymaster-merchant as a deposit and not a loan.<sup>210</sup> An agreement to pay other than in the place of the transaction is approved in connection with the sale of goods but not otherwise.<sup>211</sup>

Thus, being characterized as a loan, as a matter of strict doctrine, the *suftaj* is disapproved, though not forbidden, under the Hanafi law, and is virtually forbidden altogether under all other three schools. Maliki law permits it only in

<sup>205</sup> See text around n 151 above.

<sup>206</sup> Which was not always the case; thus, a creditor in one city who received a *suftaj* payable in another city had to make his arrangements for the delivery of money between the two cities; in the absence of correspondent arrangements between the two cities transportation had to be physically made. See the example given by Goitein, above n 104 at 245, fn 86.

<sup>207</sup> In this context, however, attention has not been paid to the commission or fee paid out by the debtor to the paymaster for the issue of the *suftaj* and hence arguably, to cover the cost of the physical transport from place to place. For the debtor's commission see text and n 168 above.

<sup>208</sup> *The Hedyā*, above n 28 at 333–34.

<sup>209</sup> *Ibid.*

<sup>210</sup> Grasshoff, above n 175 at 22 cites a source rationalizing the 'loan' (as opposed to the 'deposit') conceptualization on the basis of repayment of an equivalent sum as opposed to the same coins originally delivered.

<sup>211</sup> Santillana, above n 136, note on Art 1964 at 689–91.

the case of extreme necessity; on their part, Shafi'i and Hanbali law go only as far as to give a legal effect to the engagement of the paymaster-‘borrower’ where it is voluntarily assumed and not on the basis of his agreement with the debtor-‘lender’.<sup>212</sup>

Ultimately however, major schools may have converged: Maliki lawyers have come to recognize the validity of the *suftaj* on the basis of ‘necessity’ and Hanafi doctrine has come to adhere to the fiction of a voluntary undertaking by the paymaster-borrower. Accordingly, under Hanafi law, it is effectively forbidden to lend on the explicit condition of repayment elsewhere, but not to borrow and undertake repayment elsewhere.<sup>213</sup> Another version of the ‘approachment’ is that some Maliki scholars have been prepared to recognize a general danger in transit, and not merely a specific danger on the road to a given merchant, as permissible grounds for the use of the *suftaj* instead of the physical transport of money along that route. On their part, Hanafi scholars have come to embrace the *suftaj* as long as the repayment obligation elsewhere is implicit and yet non-obvious. Finally, even Shafi'i rules have come to allow the use of the *suftaj* where it is in conformity with a local usage.<sup>214</sup>

Wherever the use of a *suftaj* was unlawful, undesirable or unavailable,<sup>215</sup> payment to a distant place was to be made in specie, namely, by the physical transport and delivery of money.<sup>216</sup> In such a case, the debtor bears the risk of loss in transit, unless of course he delivers the money in his own location to the creditor's agent. As well, at least in theory, payment to a distant place could be carried out in two other ways. First, it could be made by means of a *hawale* on an obligation that happened to be payable at the desired place. Second, possibly, one obligated on an existing debt to the debtor, may be persuaded to agree to pay at a place (and possibly to a party) other than the original. However, I suspect that other than in connection with the obligation to pay the price of goods sold,<sup>217</sup> both these methods, particularly the latter, may be perceived as conferring on the debtor ‘profit upon a loan’ and thus no less unlawful than the *suftaj*.<sup>218</sup>

What remains enigmatic however is the geographic distribution of *suftaj* operations in the Medieval Islamic Near East. As will be recalled, while Hanafi

<sup>212</sup> Ray, above n 34 at 64–65.

<sup>213</sup> Santillana, above n 136, note on Art 1964 at 689–91.

<sup>214</sup> See Ashtor, above n 102 at 568–69. The two versions are not identical: ‘necessity’ under Santillana, *ibid* is not the same as ‘general danger’ according to Ashtor (for the Maliki school) and unlike Ashtor, Santillana does not preclude an explicit condition of repayment elsewhere, as long as it appears to emanate exclusively from the paymaster-borrower (for the Hanafi School).

<sup>215</sup> According to Goitein, above n 104 at 243 *suftajs* ‘were not always easy to come by.’ He associates it with the fact (alluded to at the beginning of section 3.3 above) that ‘they were issued by and drawn upon well-known bankers or representatives of merchants, a fee was charged for their issue, and after presentation a daily penalty had to be paid for any delay in payment.’ *Ibid*.

<sup>216</sup> One specific practice for making cash payments to distant places was that of dispatching money in sealed purses. See eg Goitein, *ibid* at 240. See also at 245 where he speaks of the ‘circulation of purses’ as being an alternative for the ‘remittance by *suftajas*.’

<sup>217</sup> See text and n 211 above.

<sup>218</sup> See text around nn 207–09 above.



law prevailed in Iraq and Syria, Maliki rules prevailed in North Africa, both in Egypt, and throughout the Maghreb, to the west of Egypt. Indeed, the thesis under which Hanafi commercial law better reflected actual practice<sup>219</sup> does not seem to apply to Islamic payment instruments;<sup>220</sup> as indicated,<sup>221</sup> Maliki rules had an edge in facilitating the operation of the *hawale* in connection with the *suftaj* as well as the other payment instruments, and there is no reason to suppose that they did not apply in Egypt. And yet, while compared to Hanafi law, Maliki rules facilitated the operation of the *suftaj* with greater ease, they were stricter as to the unlawfulness of the arrangement. Thus, availability of the *suftaj* in Iraq may be explained by the relative leniency of Hanafi rules with regard to the unlawfulness of the arrangement; by the same token, unavailability in the North African Maghreb may be attributed to the greater strictness of Maliki law with regard to that point.<sup>222</sup> On the other hand, abundance in Egypt, whether for payments going to or coming from the East, and particularly, for domestic payments, may be explained by the greater ease in which the *suftaj* could be facilitated under the Maliki law.

This however does not explain the different situation in Egypt compared to that in the Maghreb; that is, it is hard to see why illegality considerations prevailed in the Maghreb, while operational advantages tipped the balance in Egypt. Nor does convergence of rules explain availability of the *suftaj* in Egypt and its unavailability in the Maghreb. Hence, one may speculate that it is not legal reasons, but rather, business and practical considerations, which determined the result in each location. For example, it may well be the case that adequate networks of paymasters and their correspondents existed both inside Egypt and throughout the area between Egypt and Iraq, but not over the Sahara, namely, between Egypt and the Maghreb.<sup>223</sup>

#### 4. CONCLUSION: *HAWALE*, *SUFTAJ* AND THE BILL OF EXCHANGE

In his monumental work on the history of English law, Holdsworth is sceptical as to whether the modern bill of exchange is a true derivation from the business practices of the Arabs. He nevertheless speaks of the Arabs using 'something very much like the modern bill of exchange' that as early as the eighth century CE:

<sup>219</sup> See AL Udovitch, 'The "Law Merchant" of the Medieval Islamic World' in GE von Grunebaum, *Logic in Classical Islamic Culture* (Wiesbaden: Otto Harrassowitz, 1970) at 113. He restates the same view in eg Udovitch, 'Theory', above n 174 at 290. The view is however stated to particularly apply to commercial associations.

<sup>220</sup> This critique is in the footsteps of Ray, above n 34 at 79–80.

<sup>221</sup> See section 3.3, particularly text around n 201 above.

<sup>222</sup> This indeed appears to be the explanation of Ashtor, above n 102 at 568–69 (in conjunction with 567).

<sup>223</sup> To that end, see eg Goitein, above n 104 at 244–45.

could pass from hand to hand by something very much like an indorsement; and, to use modern terms, the payee [thereof] had a right of recourse against the drawer in the event of non-payment by the acceptor.<sup>224</sup>

The present study does not support this specific observation. First, the eighth century may be too early a milestone, at least for a solid record of Medieval Islamic payment instruments.<sup>225</sup>

Second, there is no indication that at any time Medieval Islamic payment instruments were endorsable, that is, that their transfer was accomplished by the delivery plus the endorsement signature by the transferor of the instrument.<sup>226</sup>

Third, in the case of default by the drawee (being either the correspondent or paymaster), both Hanafi and Maliki rules permit recourse by the creditor-payee against the drawer (being either the paymaster or the debtor) as well as against the remitter (being the debtor) only under narrow circumstances.<sup>227</sup>

Furthermore, even some premises underlying Holdsworth's observation may appear to be exaggerated.

To begin with, already before the advent of Islamic law, both the circulation of credit<sup>228</sup> and the non-cash payment between distant parties<sup>229</sup> had been avail-

<sup>224</sup> W Holdsworth, *A History of English Law*, 2nd edn (London: Methuen & Co, Sweet and Maxwell, 1937, reprint 1966) vol VIII at 133, whose observation to that effect is the starting point of JM Holden, *The History of Negotiable Instruments in English Law* (London: University of London The Athlone Press, 1955, reprint 1993, WM W Gaunt & Sons) at 1. Holdsworth is explicitly relying on Huvelin, 'Travaux', above n 5. See also CHS Fifoot, 'The Development of the Law of Negotiable Instruments and the Law of Trusts' (1938), 59 *Journal of the Institute of Bankers* 433, 433. For 'indorsement' as effectively interchangeable with 'endorsement' see Holden, *ibid* at 44, fn6.

<sup>225</sup> Huvelin, *ibid* at 24 vaguely points to the eighth century CE as the starting point for the financial system that gave rise to the Islamic payment instruments. In fact, the earliest documented *sakk*, operating as a *hawale*, may go back to the late-seventh century CE. See FD Chester, 'On early Moslem promissory notes' (1896), 16 *Journal of American Oriental Society* 43 as analysed by Ray, above n 34 at 67. However, Ashtor, above n 102 at 558 speaks of the *suftaj* as going back to 'the ninth century'. Extensive use nevertheless dates from a later period. See the beginning of section 3.1 above.

<sup>226</sup> But cf Ashtor, *ibid* at 564 who maintains that 'the Arabs had been using endorsements since the days of the caliphs as can be deduced from tenth century texts.' Huvelin *ibid* at 24 speaks of endorsing a *suftaj* in the sense of transferring the debt obligation on it by means of a *hawale*. Even Ashtor, *ibid* at 570 appears to use 'endorsee' in the sense of 'transferee', hence, not in its technical and usual sense. For the *suftaj* as transferable in theory but not in practice, see text around nn 202–06, above, and for the Islamic payment instruments as non-endorseable, see text and n 128 above.

<sup>227</sup> See text around nn 44–53, 195 and 199–200. The point is conceded by Huvelin, *ibid* at 23, who, as already indicated in text around nn 174–76 nevertheless goes on to argue (at 24) that recourse is available to the creditor. As indicated, his position on the point appears to be erroneous. See text that precedes paragraph containing n 186 above.

<sup>228</sup> Credit can be circulated where, having become entitled to receive payment from the paymaster, the delegatee re-delegates the paymaster to make payment to the delegatee's own creditor. See K Verboven, 'Faeneratores, Negotiatores and Financial Intermediation in the Roman World (late Republic and early Empire)' in K Verboven, K Vandorpe and V Chankowski (eds), *Pistoi Dia Tèn Lechnèn-Banks, Loans and Financial Archives in the Ancient World: Studies in Honour of Raymond Bogaert* (Leuven: Peeters, 2008) at 227, which touches upon the service of arranging delegations to transfer existing debts from one person to another.

<sup>229</sup> For intercity non-cash payments in Ancient Rome see eg G Platon, *Les Banquiers dans la Législation de Justinien* (Première Partie) (Paris: Librairie Recueil Sirey, 1912) at 108–09. Both the circulation of credit and non-cash payments between distant parties by means of a series of either delegations or cessions under Roman law are discussed in this book in ch 5, section 10 above.

able under Roman law by means of a series of either delegations or cessions. As already indicated,<sup>230</sup> the *hawale* operates in a similar manner to that of the Roman delegation under Hanafi rules, and like a cession under the Maliki school. From that perspective, Islamic law did not move legal doctrine any further than Roman law had already done. Moreover, Islamic law may have constituted a step back from the developments of Roman law in that Islamic law does not facilitate the accrual in the hands of a creditor of an 'abstract' right, namely an entitlement from the paymaster (or his correspondent) to the sum of the money to which the obligation relates, free of defences available to the parties in their bilateral relationships.<sup>231</sup>

Holdsworth's observation appears to be exaggerated also in another respect. Transferability of a debt in association with the physical transfer of the debt instrument is not an Islamic innovation. Thus, as was already indicated, a bearer clause binding a paymaster to pay the presenter of the document containing that clause had been effective in the ancient Near East far before the advent of Islam.<sup>232</sup> As well, the transferability by delivery of a loan document payable by the borrower to his lender, almost<sup>233</sup> as if it were an ordinary chattel,<sup>234</sup> goes back to the Jewish Talmud<sup>235</sup> and thus preceded Islam.<sup>236</sup>

In any event, even assuming similarity between the *suftaj* and the bill of exchange, and recognizing that Continental Europe may have been familiar with the *suftaj*,<sup>237</sup> one may share Holdsworth's scepticism as to actual parent-

<sup>230</sup> See text around nn 62–65 above.

<sup>231</sup> For this result in Roman law under the absolute (or pure) delegation see Maxwell, above n 65 at 95–105. See discussion in this book in ch 5, section 6.2 above.

<sup>232</sup> See paragraph concluding with n 125 above.

<sup>233</sup> The qualification is designed to point out that while *mesira* (delivery) is available for the transfer of a loan document, not all methods for transferring a chattel, such as *hagbaha* (lifting) and *meshicha* (drawing near or pulling), as well as *chalifin* (barter, namely, the exchange of two chattels) are available for acquiring ownership in a loan document. For such modes of acquisition for chattels in general, see Talmud Bavli, *Kiddushin* at 25B (as well as 22B) and *Bava Batra* at 84B, as well as *Bava Metzia* at 46A. For the inadequacy of *meshicha* (drawing near or pulling) (and hence the need for physical delivery by the transferor, ie *mesira*) see eg Talmud Bavli, *Bava Batra* at 76A, commentary by both Rashi D'H 'Ve-otiyot bimsira', and Tosafot, D'H 'Iy'. For the inadequacy of *chalifin* for the acquisition of a documentary note of indebtedness on a loan see Talmud Bavli, *Bava Batra* at 77, commentary by Tosafot, D'H 'Amar Ameimar'.

<sup>234</sup> This is so even though it is recognized that unlike an ordinary chattel the loan document has no intrinsic value. See eg Talmud Bavli, *Bava Kamma* at 62B (dealing with a thief's exemption to pay the double payment for which a thief of an ordinary chattel is liable) and 98A (dealing with loss incurred when a loan document is burnt). Lack of intrinsic value in a loan document is also alluded to eg in Talmud Bavli, *Kiddushin* at 9A, 26A, and 48A.

<sup>235</sup> See text around nn 239–44 below. In contrast, in Ancient Mesopotamia, an acknowledgment of debt document was transferable only subject to the debtor's consent. See Bogaert, *Les Origines*, above n 8 at 123–24, and discussion in this book, ch 3, section 2, text that follows n 38 above.

<sup>236</sup> The Talmudic era is said to come to its end in 500 CE, a year that marks the final reduction of the Talmud Bavli (that is, Babylonian Talmud). See eg A Steinsaltz, *The Talmud—The Steinsaltz Edition – A Reference Guide* (New York: Random House, 1989) at 2, 32. This preceded the advent of Islam in the seventh century. The Talmud is written in Hebrew and Aramaic. For the Talmud and a glossary of post-Talmudic Jewish law sources, see c 4, respectively n 1 and appendix.

<sup>237</sup> Both aspects are discussed by Ashtor, above n 102, respectively at 562–65 (focusing on distinctions) and 570–72 (focusing on Venice's trade in the Near East at the time of the Crusaders).

hood; the latter cannot be asserted with certainty. As Udovitch stated in another context:<sup>238</sup>

Determining cultural and institutional influences between civilizations and peoples is a complex and elusive undertaking. In the absence of clear and decisive evidence it is difficult to decide whether similar ideas and techniques are the result of direct transmission from one group to another or are independent responses to similar challenges.

And yet, we are not precluded from observing the evolution of human thought from one civilization to another, even without being able to factually determine parenthood for concepts and institutions. To that end, one may take note of the fact that unlike any earlier legal doctrine or institution, Maliki rules governing the *hawale* heralded the negotiable instrument in two ways.

First, in providing a legal framework facilitating the transferability (though not full negotiability) of the *ruq'a* and *sakk* payable to bearer, the *hawale* under Maliki rules goes beyond the mere recognition of instruments payable to bearer in the ancient Near East. Moreover, Maliki rules do not distinguish between the transferability of instruments payable to the bearer and instruments payable to a named payee; effectively, both are transferable by delivery. In sum, Maliki law thus provides for solid rules to govern a simplified procedure for the transfer by delivery of informal debt instruments. In contrast, under the Talmud, to be transferable, a documentary note of indebtedness may have to comply with formality requirements,<sup>239</sup> even if only as to adequate witnessing.<sup>240</sup> Furthermore, the Rabbis disagreed as to whether by itself, the delivery of the documentary

Familiarity with the *suftaj* may have been the result of trade relations between the Eastern and Southern Mediterranean for which see eg EH Byrne, 'Commercial Contracts of the Genoese in the Syrian Trade of the Twelfth Century' (1916), 31 *Quarterly Journal of Economics* 128 at 157; and AE Sayous, 'Le Commerce de Marseille avec la Syrie au Milieu du XIII Siècle' (1929), 95 *Revue des Études Historiques* 391.

<sup>238</sup> Udovitch, 'Commenda', above n 172 at 207.

<sup>239</sup> Formal debt documents may go back to the Greek *chirograph* and *syngraph* mentioned in n 117; however they were not transferable. Under the Talmud, a formal legal document, or deed, is called *shetar*. 'Every *shetar*, as a formal document, requires the signatures of witnesses.' Otherwise, an informal unwitnessed document is a mere piece of evidence for an oral contract. See AM Fuss, 'Shetar' in M Elon (ed), *The Principles of Jewish Law* (Jerusalem: Keter, 1975) (reprinted from Encyclopaedia Judaica, 1st edn) Columns 183–90 at 184. But according to Maimonides (the Rambam, 1135–1204), for a documentary note of indebtedness on a loan (*shetar hov*) manually written by the debtor there are no formal requirements other than as witnessing. See Rambam, *Mishpatim: Hilchot Malveh ve-Loveh*, Section 11, Rule 2, as well as Section 27, Rule 1. The Rambam's work is in Hebrew. The transfer of a note of indebtedness under Talmudic law is discussed in ch 7, section 2.2, text and nn 61–90 below.

<sup>240</sup> The Talmud records a disputation as to whether a documentary note of indebtedness (*Shtar Hov*) has to meet witnessing requirements. See Talmud Bavli, *Gitin* at 86B. Maimonides upholds witnessing requirements with respect to either the signature of the debtor or the delivery by him of the document to the creditor. See Rambam, *ibid* Section 11, Rules 2 and 3. According to the Magid Mishna commentary to the Rambam, *ibid*, this reflects the majority view among the post-Talmud Rabbis. Delivery witnesses as a replacement for signature witnesses are discussed eg by Rashi, Talmud Bavli, *Bava Batra* at 176, D'H 'Vegoveh'. Witnessing requirements are also discussed in Choshen Mishpat Sections 40 and 51 in both *Tur* (Rabbi Jacob ben Asher: 1270–1343) and *Shulchan Aruch* (Rabbi Josef Karo: 1488–1575). Both sources are in Hebrew.

note of indebtedness is adequate to transfer the right to collect the debt,<sup>241</sup> or whether, to that end, an accompanying properly executed bill of sale is also required from the transferor-lender.<sup>242</sup> In the footsteps of the transferable debt document, such a bill of sale may have to comply with formality requirements, even if only as to witnessing.<sup>243</sup> Indeed, it is undisputed that in conjunction with the physical delivery<sup>244</sup> of the debt instrument, the Talmudic sages uphold the transferability of the right to collect on it; nevertheless, ironically, in striving to provide clear and certain rules, but then in disagreeing on what they are, the Talmudic sages increased uncertainty. Thus, taking into account the requirements and disputations just discussed, compared to Maliki law, the applicable legal framework under the Talmud is less certain and possibly more cumbersome. In the final analysis, one cannot fail to note the contribution of Maliki rules to the facilitation of transferability by the simple delivery of an informal debt instrument.

Second, without formally invoking cession, and though by itself (at least in practice) non-transferable, the *suftaj* accords to the creditor a direct entitlement against the paymaster as well as his correspondent. Under Maliki rules, the creditor's entitlement to enforce the obligation of the paymaster is on the paymaster's obligation to the debtor; the creditor's entitlement to enforce the obligation of the correspondent is on the correspondent's debt due to the paymaster. Either way, the creditor's entitlement does not require a reaffirmation or a renewed obligation to be undertaken by the party liable. Rather,<sup>245</sup> the accrual in the creditor's hands of an entitlement towards first the paymaster and second the correspondent is on the basis of the transfer of the *suftaj* document by the debtor to the creditor. Entitlement against the correspondent is certainly a

<sup>241</sup> Those satisfied with the power of the mere delivery of the document to transfer the right to collect the debt nevertheless disagreed as to whether a transferee or in fact any person in possession of a documentary note of indebtedness payable to another person is required to prove title (namely receipt by way of transfer or by way of gift from the named payee or someone deriving title from him) or suffice it for him to rely on his possession. See Talmud Bavli, *Bava Batra* at 173A.

<sup>242</sup> See Talmud Bavli, *Kiddushin* at 47B–48A where it is further disputed as to whether to effect a transfer the bill of sale (if needed) is required to contain prescribed language as well as to whether the transfer of the right to collect on a documentary loan forfeits altogether the power of the lender to release the borrower. See also Talmud Bavli, *Bava Batra*, 75B–77B (with Tosafot at 77A D'H 'Amar Ameimar'), Talmud Bavli, *Sanhedrin* at 31A, and Talmud Bavli, *Yevamot* at 115B. On the post-transfer release by the lender see also Talmud Bavli, *Bava Metzia* 20A and *Ketuvot* 85B–86A. For a summary that appears to support a bill of sale requirement for the transferability of the documentary note of indebtedness see Choshen Mishpat above n 240, Section 66. See in general, AM Futh, 'Assignability of Debt and Negotiable Instruments in Jewish Law' (1984–85), 12 *Diné Israel* 19.

<sup>243</sup> Being a legal document, the bill of sale is a *shetar* (for this term see n 239 above); as such it is subject to the same requirements and disputations as the documentary note of indebtedness.

<sup>244</sup> Even commentators who are satisfied with 'constructive delivery' for ordinary chattels (eg Tosafot, D'H 'Behema' commenting on Talmud Bavli, *Kiddushin* at 25B) insist on the physical (or actual) delivery (from hand to hand) for a documentary note (eg Tosafot, D'H 'Iy' commenting on Talmud Bavli, *Bava Batra* at 76A).

<sup>245</sup> See text around n 197 above.

Maliki innovation.<sup>246</sup> Since the correspondent's undertaking is not recorded on the *suftaj* document as issued by the paymaster to the debtor and sent to the creditor,<sup>247</sup> no such entitlement can be made available to the creditor under the Talmud.<sup>248</sup>

While the transferability by delivery feature is the forerunner of negotiation, the direct entitlement feature is the precursor of the acceptor's liability to the payee on a bill of exchange. Indeed, Islamic law and practice ended up arresting the development of their own innovation; Islamic practice did not encourage the circulation of the *suftaj*, and Islamic doctrine was hostile to the paymaster's obligation on the *suftaj*. In the final analysis, however, fundamental elements of the bill of exchange, both as a negotiable instrument and machinery for the transfer of funds, are traceable to Islamic instruments and legal doctrine. True, Roman law had facilitated the circulation of credit in the form of a series of re-delegations or re-assignments; in turn, Jewish law had sown the seeds of transferability by delivery of debt instruments. Early Medieval Islamic law, particularly the Maliki rules in Egypt, combined and enhanced both achievements. By giving effect to a mere delivery accompanied by an informal agreement, these rules provide for a simple mechanism to accomplish the circulation of informal instruments of credit. Each such instrument contains the explicit undertaking of a paymaster, and as applicable, the implicit liability of his correspondent. Improvements, particularly in the form of full negotiability for the instrument, and party's liability on an absolute abstract obligation to pay a sum of money, were to come later and originate elsewhere.

<sup>246</sup> For the Maliki innovation with respect to the creditor's entitlement towards the paymaster, see discussion in the immediately preceding paragraph.

<sup>247</sup> See text around n 197 above.

<sup>248</sup> Certainly, under the Talmud, liability on a documentary note of indebtedness, whether to the original creditor or his transferee, is on the basis of the undertaking on the note. For post-Talmudic adaptation to Islamic legal environment on the point per Gaonic Response No 423, reproduced in AA Harkavy (ed), *Gaonic Reponsa* (NY: Menora, 1959) [recorded in the original Judeo-Arabic and Hebrew translation], further discussed at length in ch 7, section 4 below; see G Libson, *Jewish and Islamic Law: A Comparative Study of Custom During Geonic Period* (Cambridge, Mass: Harvard University Press, 2003) at 96–97 and nn 26–33. The *Gaonim*, or 'excellencies', were post-Talmudic sages and scholarly leaders, first in Babylonia and then beyond, in a period that extended approximately from the seventh to around the middle of the thirteenth century CE, prior to the ascent of European Jewry. More information can be found online: [www.britannica.com/eb/article-9036016?query=gaon&ct=](http://www.britannica.com/eb/article-9036016?query=gaon&ct=).

# Funds Transfers under Talmudic<sup>1</sup> Law: Orthodoxy and Adaptation

|                                                                                                              |     |
|--------------------------------------------------------------------------------------------------------------|-----|
| 1. Introduction                                                                                              | 307 |
| 2. Transfer of Ownership in Money Owed                                                                       | 309 |
| 2.1 Money Owed on Loan or Deposit                                                                            | 309 |
| 2.2 Direct Mechanisms for the Transfer of Money Owed                                                         | 312 |
| 2.3 Transfer of Money Owed by Authorizing the Creditor to Collect<br>from the Paymaster: The <i>Urcheta</i>  | 321 |
| 2.4 Transfer of Money Owed by Turning the Creditor's Agent to a<br>Paymaster: The <i>Dyokani</i>             | 326 |
| 2.5 Summary                                                                                                  | 329 |
| 3. Instructing a Paymaster to Pay the Creditor Money Owed by Means of<br>a Presence-of-all-three Declaration | 330 |
| 4. Remitting Coins to a Distant Place: The <i>Dyokani</i> Transformed                                        | 342 |
| 5. Conclusion: The Talmudic Contribution                                                                     | 350 |

## 1. INTRODUCTION

ACCORDING TO THE Mishna in *Bava Kamma*, a debtor is obligated to seek out his creditor and is not discharged until he makes full payment to the creditor. Stated otherwise, the debtor ‘may not [pay] to [the creditor’s] son nor to [the creditor’s] agent’; rather, the debtor is required to pursue the creditor in person even to a faraway country.<sup>2</sup> This does not, however, preclude a creditor from agreeing to look to a party nominated by the debtor (hereafter: ‘paymaster’) for payment in discharge of the debtor’s debt to him. On his part, the paymaster may have owed money to the debtor, in which case, either paying or even incurring liability by the paymaster to the creditor would discharge the paymaster’s debt to the debtor. To that end, an instruction by the debtor to the

<sup>1</sup> For the Talmud and glossary of Jewish law sources, see above, ch 4, n 1 and Appendix respectively.

<sup>2</sup> Talmud, *Bava Kamma* at 103A. Strictly speaking, this Mishna deals with payment by a robber or tortfeasor who wishes to repent. It is, however, not to be so narrowly read, but rather, it is to apply equally to the discharge of any monetary liability.



paymaster who owes money to him to pay the creditor may initiate a funds transfer under which, having owed money to the debtor, a paymaster may become indebted to the creditor. Alternatively, in the case fully discussed in chapter four above and thus excluded from the present discussion, where the paymaster does not owe money to the debtor, upon compliance with the debtor's instruction, the paymaster is to extend credit to the debtor and become his creditor.

This chapter considers the effect under Talmudic law of the payment order initiating a funds transfer under which, having owed money to the debtor, a paymaster may become indebted to the creditor. Section 2 deals with various methods for the transfer of ownership in money owed on a loan or deposit. Mechanisms for the transfer of ownership in money owed, whether on a loan or deposit, are to be explored in that section first in the broader context of the transfer of property under the Talmud, and second in the context of specialized techniques, namely the *Urcheta* and *Dyokani*.

Against either the unavailability or inadequacy of methods discussed in section 2, section 3 analyses the effect of an instruction, given in the presence of all three, by the debtor to a paymaster owing money to him. The section discusses the legal underpinning of the transmission into the hands of the creditor of money owed by the paymaster to the debtor, in circumstances where all three are present together in the same place.

Section 4 examines the treatment of Islamic payment instruments under Talmudic law. Such instruments, discussed in detail in chapter six above, were designed to transmit to a creditor money owed by a paymaster to the debtor. They were heavily used by Jews living in the Near East in the post-Talmudic era, during the tenth and eleventh centuries, also in connection with payments from place to place. The legal underpinning of these instruments under Talmudic law, in breach of orthodoxy as set out in the previous sections, is the theme of section 4.

Finally, section 5 highlights the threefold Talmudic contribution to the modern law governing payment orders: the adoption of a document resembling the bill of exchange, the provision of a framework for negotiability, and the recognition of the principle of conditional payment.

As in connection with chapter four above, I recognize that views and interpretations of post-Talmudic commentators discussing Talmudic texts do not necessarily reflect the precise meaning of those texts as they were understood in the days of the Talmud. However, as set out in the Glossary appended to chapter four, most such commentators are of Medieval vintage, which is in line with the flow of the overall discussion of this book, from Antiquity to the Middle Ages. Moreover, these commentators regarded the Talmudic texts as fully authoritative and binding; working from inside them, and certainly, not purporting to depart from them, they endeavoured to ascertain and implement their original meaning.<sup>3</sup> This gives a measure of credibility to their interpretation.

<sup>3</sup> As will be seen in section 4 below, in connection with payment instruments, a rare occasion of obvious departure from the Talmudic scheme was clearly acknowledged by the Rabbis.

## 2. TRANSFER OF OWNERSHIP IN MONEY OWED

## 2.1 Money Owed on Loan or Deposit

The paymaster instructed by the debtor to pay the creditor may have owed money to the debtor either on a loan<sup>4</sup> or deposit. Money given on a loan is given to be spent;<sup>5</sup> hence the borrower is liable to return the amount of the money lent<sup>6</sup> and not the specific coins that constituted the loan. Conversely, the deposit is given for safekeeping;<sup>7</sup> hence it is to be returned in specie. Indeed, as explained below, the Talmud gives the depositary the right to use money on deposit only in very limited circumstances; when they occur, the depositary becomes liable for the amount so used.<sup>8</sup> At the same time, the Talmud does not permit a depositary for safekeeping to mix money deposited by one person with money deposited by another as well as with the depositary's own money;<sup>9</sup> hence, the Talmud has not developed a parallel to the Roman irregular deposit.<sup>10</sup> The latter allows a depositary to mix money deposited by one person with that deposited by another and thereby owe to each depositor the sum of the deposit and not the

<sup>4</sup> 'Loan' is broadly used to denote any credit transaction, for which the creditor is seen as lending money to the debtor who is bound to pay back in cash. A surcharge payable by a credit buyer is thus a violation of the interest prohibition on money lent. See Talmud, *Bava Metzia* at 65A in conjunction with 63B and 68A. But *cf* Talmud, *Bava Metzia* at 115A for discussing the effect of the 'transformation' by agreement of a debt owed on a lodging fee or wages to a loan ('zekafan . . . bemilveh') on the creditor's enforcement rights.

<sup>5</sup> For this principle, see eg Talmud, *Kiddushin* at 47A.

<sup>6</sup> Since money given for use is not (and in fact cannot) be returned in specie, it is 'lent' rather than 'rented' (and hence is subject to the prohibition on charging interest). See eg Talmud, *Bava Metzia*, at 69B (with Tosaftot D'H 'Mara'). Hereafter, 'Tosaftot' is to mean Tosaftot's editor.

<sup>7</sup> Certainly, if so agreed, and for a fee, the depositary could invest money deposited with him, either for a depositor, or even under a joint venture with him, though in the latter case, only under a mutual profit and loss sharing agreement (under which the deposit becomes partly a loan and partly an investment). See Talmud, *Bava Metzia*, at 68A and 104B. Confusingly, even money given or becoming an 'investment' is referred to as a 'deposit'. *Ibid*.

<sup>8</sup> Money returned not in specie, whether to a lender, a depositor, or an investor, must however be of quality consistent with that originally given. See eg Talmud, *Bava Metzia*, at 69A (for an investment), and *cf* Talmud, *Bava Kamma* at 97A–97B (for a loan; particularly see the difference of opinion between Rashi (at 97B D'H 'Noten lo') and Tosaftot (at 97B D'H 'Hamalveh') in the case of a coin that became disqualified).

<sup>9</sup> Prohibition to mix deposits appears to be in line with a similar practice for grain deposits in Ancient Mesopotamia as discussed by R Bogaert, *Les Origines Antiques de la Banque de Dépôt* (Leyde: AW Sijthoff, 1966) at 59, 84, fn 236, 99 text and fnn 311–13. However, for the mixture of money deposited by several people for the purpose of purchasing goods for each of them, in which case whatever is purchased – even for one of the depositors with the sum deposited by him – belongs to them all jointly, see Talmud, *Bava Metzia*, at 74A.

<sup>10</sup> This is so notwithstanding A Gulak, 'The Moneychanger's Business According to Talmudic Law' (1931), 2 *Tarbitz* 154 at 157 [in Hebrew]. Gulak claims that such a parallel exists under the Talmud in circumstances where the depositary is allowed to use the deposited money. However, per ensuing text and note, the depositary's right to use deposited money under the Roman law irregular deposit was premised on the right to mix it, which does not appear to be recognized in the Talmud.

actual coins deposited.<sup>11</sup> Thus, and subject to a narrow exception, a depositary of money under the Talmud is to return the deposit in specie.

The Talmud distinguishes<sup>12</sup> between the deposit of money in an open bag, and the deposit of money in a sealed bag.<sup>13</sup> However, the distinction is effective only where the depositary is a moneychanger.<sup>14</sup> A person other than a moneychanger<sup>15</sup> is not allowed to use the money, irrespective of whether it was deposited in a sealed or open bag. Conversely, the moneychanger is allowed to use money deposited in an open bag but not money deposited in a sealed bag.

Regardless, the moneychanger, as any other person to whom money has been deposited, is treated as a custodian of the money. Talmudic law has four categories<sup>16</sup> of custodians of chattels with a varied degree of responsibility for loss, including by theft.<sup>17</sup> Briefly stated, an unpaid custodian is liable for loss only in connection with his negligence. A paid custodian is responsible for any loss unless it occurred in circumstances beyond his control (namely, by *force*

<sup>11</sup> For the irregular deposit in Roman law see RW Lee, *The Elements of Roman Law with a Translation of the Institutes of Justinian*, 4th edn (London: Sweet & Maxwell, 1956) at 295, and R Zimmermann, *The Law of Obligations – Roman Foundations of the Civilian Tradition* (Cape Town: Juta, 1990) at 215–19. For more on the juridical nature of the irregular deposit under Roman law, see eg W Litewski, 'Le Dépôt Irrégulier', Part I (1974), 21 *Revue Internationale du Droit d'Auteur* 215, and Part II (1975), 22 *Revue Internationale du Droit d'Auteur* 279. See also WM Gordon, 'Observations on "Depositum Irregulare"' in *Studi in Onore di Arnaldo Biscardi* (Milano: Instituto Editoriale Cisalpino–La Goliardica, 1982) vol III at 363. The irregular deposit under Roman law is discussed above in ch 5, section 2.

<sup>12</sup> The principal text, on which the ensuing discussion draws, is Talmud, *Bava Metzia* at 43A *et seq.*

<sup>13</sup> More specifically, the Mishnaic text speaks of bound-up coins, namely, money in a bound-up bag. It is however explained in the accompanying Gemara text that the money, ie, the bag, must be 'bound up and sealed'. It is then questioned, but not determined, in that Gemara whether money in a bound-up bag with an unusual knot is to be treated as money in a 'bound-up and sealed' bag. For a post-biblical, pre-Mishnaic account, probably involving the deposit and return, against a document issued to the depositor, of money sealed in bags, see the Book of Tobith (or Tuvia), 1:14, 4:1, 4:20, 5:1–3, 9:1–4 (trans to Hebrew and commented on by AS Hartom 4th edn (Tel Aviv: Yavneh, 1969)). This book, belongs to the *Apocrypha*, namely, books included in the Septuagint (published in stages between the 3rd and 2nd century BCE in Alexandria, Egypt) and Vulgate but excluded from the Jewish Holy Scriptures as well as from the Protestant canon of the Old Testament.

<sup>14</sup> A comprehensive exposition of the moneychanger's business is by Gulak, above n 10. The moneychanger's primary business was money changing from one coin or denomination to another, possibly in another metal. The more precious the metal, the higher the denomination was, and during this pre-deposit banking and pre-paper money era, people needed low denomination coins for everyday transactions and high-denomination coins for saving or large value transactions. The moneychanger charged fees for his exchange services.

<sup>15</sup> It is further disputed, and not settled, in the text cited in n 12 above, whether, in this context, a storekeeper is in the same position as a moneychanger.

<sup>16</sup> By comparison, English common law purported to borrow from Roman law a six-category classification. See judgment of Lord Holt CJ in *Coggs v Bernard* (1703) 2 Ld. Raym. 909, 92 E.R. 107.

<sup>17</sup> For these categories and the scope of each one's responsibility, see Talmud, *Bava Metzia* at 93A, 94B; and Rashi, D'H 'Makné lei kfeila' in Talmud, *Bava Metzia* at 34A. For a succinct summary, see the compilation of Halakhic Concepts in A Steinsaltz, *The Talmud–The Steinsaltz Edition – A Reference Guide* (New York: Random House, 1989) at 262–63. The biblical authority for these categories and their respective responsibilities is Exodus 22:6–14, fully discussed in Talmud, *Bava Metzia* at 94B–96A.

*majeure*). A borrower of a chattel for use who is not obliged to pay for the use is responsible for any loss, including when caused by *force majeure*; he is however not responsible for loss caused by normal use of the chattel.<sup>18</sup> A renter, forming the fourth category, is likely to be responsible as a paid custodian.<sup>19</sup>

The category into which a depositary falls and hence the degree of his custodian's responsibility depends on the right he has to the use of the money on deposit. A custodian who is not allowed to use the money, namely, any depositary of a sealed bag and a non-moneychanger to whom money in an open bag has been deposited, is regarded as an unpaid custodian<sup>20</sup> who is not responsible for loss or theft, unless he is negligent. Where the custodian is allowed to use the money, namely, where he is a moneychanger to whom money was deposited in an open bag, his responsibility increases, but there is controversy as to its exact scope.

According to one view, a custodian who has permission to use the money, namely a moneychanger to whom money was deposited in an open bag, is to be treated as a paid custodian.<sup>21</sup> As such, he is responsible for loss or theft, other than when caused by *force majeure*. A more stringent view regards him as a borrower of a chattel for use who is not obliged to pay for its use,<sup>22</sup> and who, in the case of loss or theft, may not plead *force majeure* as a defence to his liability. This

<sup>18</sup> For the borrower's liability for loss caused by normal use, see Talmud, *Bava Metzia* at 96B–97A. The borrower is also not liable for loss or damage if at the time of the borrowing the owner of the chattel was working for him. See Talmud, *Bava Metzia* at 94A, interpreting Exodus 22:14.

<sup>19</sup> Talmud, *Bava Metzia* at 93A (Mishna). However, there is no universal agreement on the point. In Talmud, *Bava Metzia* at 80B (in connection with the characterization of the craftsman as a paid custodian), it is disputed whether the renter is responsible as a paid or unpaid custodian. See also Talmud, *Bava Metzia* at 93A (Gemara). The position of a craftsman as well as of a pledge holder, each as a paid custodian, is provided for in the Talmud, *Bava Metzia* at 80B (Mishna), and is further elaborated on and debated in the ensuing Gemara, particularly at 81B–82B.

<sup>20</sup> The text does not clarify why a moneychanger would undertake the custody of money without receiving any remuneration for it. Commentators speculated that in receiving a multitude of bags the moneychanger may have not been aware whether each was open or sealed. Alternatively, commentators pointed to the moneychanger's self interest in exhibiting a multitude of bags on his business premises as an indication of his financial strength or reliability, in order to attract customers who would then leave with him open bags whose contents he could use for exchange purposes for which he charges a commission. See Mordechai, Section 437 in Talmud, *Bava Metzia*; see also Yachin U'Voaz in Mishna, *Mehila*, Perek 6, Mishna 5.

<sup>21</sup> The moneychanger's remuneration is in the form of his ability to use the money in his money-changing business. The Mishnaic text cited in n 5 above further suggests that he may use the money for an opportune profit-making transaction. But according to one modern view, the text refers, rather, to the depositor's ability to make profitable use of the deposited money, as long as it has not been in actual use by the depositary. According to this view, the depositary is to be regarded as a paid custodian due to the common enjoyment shared between him and the depositor prior to the actual use of the money by the depositary. See YM Margalio (1942), 16 Hapardes 2:23–4 and 4:34–6 [in Hebrew].

<sup>22</sup> The depositary uses the money without being obliged to pay for its use since under Jewish law, no interest may be charged. Prohibition is based on three biblical cites and exists for any transaction where a party is obligated to deliver or pay in genre. These biblical verses are Exodus 22:24, Leviticus 25:36–7, and Deuteronomy 23:20. Nonetheless, it is less obvious why the safekeeping of the money is not remuneration to the depositor. According to one modern view, this is so since, as in the case with any borrower of a specific chattel for use who is not obligated to pay for the use, the entire use and enjoyment, from which liability stems, is in the depositary's hands. See Margalio, *ibid*.

controversy exists only as long as the moneychanger has not actually used the money. It is agreed that once the money has been used, the moneychanger falls into this latter category of a borrower of a specific chattel who is not obliged to pay for its use<sup>23</sup> and who is also responsible for losses caused by *force majeure*. It was left to a post-Talmudic authority<sup>24</sup> to draw what seems to be an inevitable conclusion that once the money has been used, the moneychanger becomes absolutely liable for the return of the sum so used as a borrower under a money loan.<sup>25</sup>

## 2.2 Direct Mechanisms for the Transfer of Money Owed

Mechanisms for the transfer of ownership in money owed, whether on a loan or deposit, are first to be explored in the broader context of the transfer of property under the Talmud. As means for the conveyance of property in general, they may thus be referred to as direct mechanisms.

The starting point in Talmudic law is that for property in a chattel<sup>26</sup> to pass from one person to another,<sup>27</sup> neither payment in money<sup>28</sup> nor mere agreement or words alone<sup>29</sup> will suffice.<sup>30</sup> Rather, the ownership of a chattel passes by

<sup>23</sup> Indeed, while the money is in actual use, there is no question that the entire use and enjoyment is that of the depositary, so as to render him a borrower of a specific chattel for use who is not obligated to pay for its use.

<sup>24</sup> Rambam, *Mishpatim: Hilchot Shebela Uphikadon*, Section 7, Rule 7. Further controversies, referred to above, are determined in this text as follows: (i) a storekeeper is allowed to use money deposited with him on an equal footing with the moneychanger; (ii) the use of the money is forbidden (to both the moneychanger and the storekeeper) when the money is either bound up and sealed or bound up in an unusual knot; and (iii) up to permissible actual use, the moneychanger (as well as the storekeeper) is a paid custodian (rather than a borrower of a specific chattel who is not obliged to pay for its use) who is thus not responsible for losses caused in circumstances which are beyond his control (namely, by *force majeure*). *Ibid* Rules 6–7. In Rule 8, the Rambam determines that to avoid liability for negligence, an unpaid custodian, other than a moneychanger or storekeeper, must bury the money in the ground.

<sup>25</sup> Nevertheless, while under the Talmud, *force majeure* is a defence which is unavailable to both a borrower under a money loan and a borrower of a chattel for use who is not obligated to pay for its use, there are still subtle differences, providing for tenuous qualifications, at least in theory, to the absolute nature of the liability of each type of borrower. Eg, a borrower of a chattel for use is not responsible if the article is destroyed during normal use by the borrower; see sources cited above in n 18. Arguably, however, this will not apply to the loss of money through a bad investment. Conversely, under Jewish law, a money loan may technically be released in a seven-year cycle of abandonment of debts. See Deuteronomy 15:2.

<sup>26</sup> Land is, however, acquired by payment in money, documentary note, and taking possession. See Talmud, *Kiddushin* at 26A.

<sup>27</sup> Words and payment will, however, suffice to consecrate property (rather than to transfer it to another person) to a religious trust. See Talmud, *Kiddushin* at 28B.

<sup>28</sup> See Mishna in Talmud, *Bava Metzia* at 44A. And yet taking advantage of this rule is morally deplored. *Ibid* as explained in Beraitha, *ibid* at 48A (transgressor is to obtain his retribution from Heaven).

<sup>29</sup> One manifestation of this position, as well as the disfavour in which it has been viewed, is in Talmud, *Bava Metzia* at 48A, where a Beraitha is quoted as saying that ‘one who buys and sells with words [alone] has not acquired [anything] but the sages are not pleased with one who backs out [of] his verbal commitment.’

<sup>30</sup> Qualifications to this principle are alluded to in the paragraph that follows.

means of a formalized procedure, in the form of a proprietary act, called a *kinyan*, carried out in the object to be transferred.<sup>31</sup> Typical proprietary acts involve the change of possession; depending on the type of object, such acts are *hagbaha* (lifting) and *meshicha* (drawing near or pulling) by the transferee, as well as *mesira* (delivery or handing over) by the transferor.<sup>32</sup> Consistent with this requirement, neither the owner nor the thief may sell stolen goods; the owner is precluded by lack of possession or control and the thief is precluded by lack of ownership.<sup>33</sup> Similarly, the majority of sages preclude the transfer of ownership in non-existing or future goods;<sup>34</sup> that is, under the majority view in the Talmud, ownership in such goods will not pass to the transferee automatically when such goods come into existence or become the property of the transferor. Certainly, an intangible such as a monetary debt may be neither possessed nor physically transferred; hence, it can be neither owned nor disposed of.<sup>35</sup>

And yet the proprietary act requirement in relation to the chattel to be transferred may not have been absolute or universal; surely, the Talmud facilitates the acquisition of a chattel by means of *chalifin* or barter, namely, the exchange of two chattels, a procedure that involves a proprietary act in relation to only one of the chattels to be transferred.<sup>36</sup> One type of *chalifin* is that of *kinyan sudar*, or the transfer of ownership in a chattel by means of giving or drawing a kerchief. Under this procedure, the transferor of an object receives or takes from the transferee a kerchief, in return for which ownership passes to the transferee in the chattel to be transferred, while it is still in the possession of the transferor, and without any reference to a proprietary act in it.<sup>37</sup> Furthermore, the inadequacy of a promise or 'admission' to pass or acquire property has not been consistently upheld; under some circumstances passage of property by a promise or 'admission' was recognized, and at certain times it was truly effective.<sup>38</sup> According to one modern view, historically, as a mode of conveying ownership

<sup>31</sup> See eg Talmud, *Kiddushin* at 22B, 25B–26A.

<sup>32</sup> See in general Talmud, *Kiddushin* at 25B (as well as 22B) and *Bava Batra* at 84B.

<sup>33</sup> Talmud, *Bava Kamma* at 70A. Strictly speaking the statement referred to the sanctification of the stolen object rather than to its sale, though it is understood that it applies to any transfer of ownership including sale.

<sup>34</sup> See eg Talmud, *Bava Metzia* at 33B.

<sup>35</sup> This is also the conclusion from these sources of S Albeck, 'The Assignment of Debt in the Talmud' (1957), 26 *Tarbiz* 262 [in Hebrew] (hereafter: Albeck, 'Assignment of Debt'). See also S Lerner, 'The Assignment of Secured Debt in Jewish Law' (1980) *Mechkarei Mishpat (Bar Ilan)* 197 [in Hebrew], highlighting the possibility of transferring a secured debt by means of the physical transfer of the pledge that secures it.

<sup>36</sup> For the broad principle under which 'all movables acquire one another', see Mishna in Talmud, *Bava Metzia* at 44A. For one implication, see Mishna, *ibid* at 100A. Presumably, however, a proprietary act in relation to one of the chattels to be transferred will suffice to transfer both chattels only as long as the parties have not assigned a specific monetary value to the chattels exchanged; where such value has been assigned, a proprietary act must nevertheless be performed in each chattel. See Beraitha, *ibid* at 47A.

<sup>37</sup> For *kinyan sudar*, see Talmud, *Bava Metzia* at 47A.

<sup>38</sup> The *oditta*, discussed below in the paragraph that follows, is an example in point. As well, cf Talmud, *Bava Metzia* at 94B, speaking of the acquisition of the services of the owner of a borrowed chattel by 'utterance'.

or affecting a *kinyan*, a promise or 'admission' even preceded the proprietary act procedures.<sup>39</sup>

Coins, which constitute money, are physical objects that can be owned and transferred. Being in some way distinguishable from other chattels, money may nevertheless not be transferred by means of *chalifin*;<sup>40</sup> this is true also for money held for the owner on deposit with a custodian.<sup>41</sup> However, other methods for the transfer of chattels are available for the transfer of ownership in money, including in money belonging to one person and deposited with and actually kept by a custodian.<sup>42</sup> The latter's physical possession of the money is under the control and hence the legal possession of the owner, who is thus considered to both own and possess the deposit, so as to be capable of transferring its ownership.

A deposit of goods or money may be transferred by the depositor to a transferee by means of either *zech*i or *oddita*.<sup>43</sup> *Zech*i is literally a command conveying authority to acquire; it is a mode of benefiting the transferee by effectively appointing the custodian to carry out, on behalf of the depositor, the proprietary act required for the transfer of deposit. Having carried out the proprietary act, the custodian is to hold the deposit for the transferee, who replaces to that end the transferor, namely, the depositor.

*Oditta* is an acknowledgement by an owner of an object, including money deposited with a custodian, that the object actually belongs to a person on whom the owner wishes to confer ownership. It effectively transfers ownership from a previous owner to a new one.<sup>44</sup> Its operation does not require the co-operation of the custodian; hence it looks superficially attractive. Most sages are of the view that *oditta* may be effective also where the acknowledgement is made by a person on his deathbed; yet they disfavour this method of transfer.

<sup>39</sup> An extensive learned discussion on the subject is that of B Lifshitz, *Promise: Obligation and Acquisition in Jewish Law* (Jerusalem: Ministry of Justice, 1988) [in Hebrew]. In ch 4, dealing with *chalifin* (Exchange), he quotes (at 335) a Beraitha from the Jerusalem Talmud (whose parallel appears also in the Talmud Bavli, *Bava Metzia* at 47A, see Lifshitz at 283) as well as citing other sources from which he concludes the existence of an evolution in modes of acquisition from a witnessed promise to *kinyan sudar* and then to a proprietary act in the subject matter of the transaction. In his view, at this stage *oditta* and *kinyan sudar* returned as valid modes for conveyance, co-existing with the proprietary procedures relating to the subject matter of the transaction.

<sup>40</sup> Talmud, *Bava Metzia* at 46A. On that point see ch 2, section 2.2, paragraph concluding with n 231 above.

<sup>41</sup> See eg Talmud, *Bava Metzia* at 46A and *Bava Batra* 149A.

<sup>42</sup> No transfer could be carried out once money on deposit was lost or stolen. The view that the depositor's claim against the custodian for the return of such money for which loss or theft the custodian is responsible (discussed in section 1 of this chapter) replaces the depositor's claim for the return of the money owed on the deposit (so as to be equally transferable) is discussed, but attributed to an erroneous rendition of the text in Talmud, *Kiddushin* at 47A–47B.

<sup>43</sup> SJ Zevin, (ed in chief), *Talmudic Encyclopedia* (Jerusalem: Yad Harav Herzog, 1955) [in Hebrew] vol 1 at 116 sv 'Oditta' and (Jerusalem: Yad Harav Herzog, 1967) [in Hebrew] vol 12 at 135 sv 'Zachin le-adam she-lo be-fanav'. See also I Warhaftig, *Undertaking in Jewish Law: Its Validity, Character and Types* (Jerusalem: The Library of Jewish Law, 2001) at 349 [in Hebrew].

<sup>44</sup> For a comprehensive discussion pointing out applicable issues and setting out various views pertaining to this mode of acquisition, see U Lavi, 'Litigant's Admission and Oddita' (5750/1990) 7 *Shaalei Daat* 158 [in Hebrew]. For viewing *kinyan sudar* as an *oditta* strengthened by a proprietary act, see Lifshitz, above n 39 at 324.



Two reasons are cited: first, the acknowledgement by a person other than on his deathbed<sup>45</sup> requires a witnessed statement; hence it is burdened with formality.<sup>46</sup> Second, the 'acknowledgement' is in fact a lie; at the time it is made, the object does not belong to the transferee, but is rather being transferred to him on the basis of the acknowledgement.<sup>47</sup>

Chattels, including money, could be conveyed from one person to another without physical transfer or otherwise giving the recipient physical control. Rather, ownership of chattels could be conveyed as an incident to the transfer of land, including a minute portion of it. Land may be acquired not only by taking possession, but also by making payment for it or under a grant contained in a bill of sale.<sup>48</sup> The acquisition of chattel as an incident to the acquisition of land is known as *kinyan agav karka*, or the transfer by dint of land. The mechanics of the transfer do not require the chattel to be placed on the land transferred.<sup>49</sup> Hence, this is an effective method to transfer a deposit held for the depositor by a custodian.<sup>50</sup> No co-operation by the custodian is required; following the transfer, the custodian will owe the money deposited to the transferee. At the same time, this method of transfer may not facilitate the transfer of money lent, the latter not being owned and possessed by the lender.

The availability of various means to transfer money deposited is examined in the Gemara account of the Issur Giora (Issur the Convert) episode.<sup>51</sup> In that case, Rava acted as a custodian for money belonging to Issur. Issur, who had no legal heirs, wanted to transfer the deposit to Rav Mari, yet Rava was unco-operative; being in actual possession, he would have been the one to gain the deposit upon Issur's death.<sup>52</sup> Thus, only methods that do not require the custodian's co-operation could be considered. Among those, in the facts of the case, resort could not be made to the transfer by the dint of land, since Issur did not own any land. Only *oditta* was available.

<sup>45</sup> An obligation or conveyance of a person on his deathbed is valid irrespective of non-compliance with formal requirements. See Talmud, *Bava Batra* 151A and 151B.

<sup>46</sup> Arguably, however, it is this formality that makes *oditta* based on something more than words alone, so as to become binding notwithstanding the lack of a proprietary act.

<sup>47</sup> For these two reasons see Maharsha, D'H 'Gufa' commenting on Talmud, *Gitin* at 13B. See also Maharshal and Maharam comments on the same page.

<sup>48</sup> Talmud, *Kiddushin* at 26A.

<sup>49</sup> Talmud, *Kiddushin* at 27A. For an account of the evolution of this mode of transfer, from a transfer of chattels incidental to, and placed in, a tract of land to be transferred, to the transfer of chattels neither related to nor situated on the land (so that in effect the transfer of the land becomes incidental to, namely only the means to, the transfer of the chattels), see S Albeck, *The Law of Property and Contract in the Talmud* (Jerusalem: Dvir, 1976, 1983) at 171–75 [in Hebrew] (hereafter: Albeck, *The Law of Property*).

<sup>50</sup> Talmud, *Bava Metzia* at 46A. See also Talmud, *Bava Kamma* 104B, for which the Rashba emended the text to refer to money deposited and not money lent. See Rashba, D'H 'Girsat hasfarim' commenting on Talmud, *Bava Kamma* at 104B.

<sup>51</sup> Talmud, *Bava Batra* at 149A. The matter is further discussed below in text and nn 143–44.

<sup>52</sup> According to Meiri, Rava did not wish to keep the money to himself but rather to hand it to Rav Mari, though as a good gesture on his own part, in order to get a good name or in order for the recipient to owe him service. See Meiri, D'H 'Shchiv mera' commenting on Talmud, *Bava Batra* at 149A.

It appears then that a depositor may transfer ownership in a deposit of money by means of a transfer by dint of land, *zechi*, and *oditta*. Among those, only *zechi* requires a voluntary act and hence the co-operation of the custodian. Both *zechi* and *oditta* require some formality; *zechi* in the form of a proprietary act, and *oditta* in the form of a witnessed document. *Oditta* is anyway disfavoured, and transfer by dint of land looks cumbersome and inappropriate for transactions in the marketplace. As well, for any such transfer to discharge a debt, consent by the transferee-creditor is required.

The position with respect to money lent under an oral loan is, however, to be distinguished from that with respect to money deposited; in the hands of the borrower, money lent is either to be spent, or already was spent, and thus is not a tangible object owned and possessed by the lender.<sup>53</sup> Indeed, under what is known as 'Rabbi Nathan's lien', one who lent to a borrower may collect directly from a debtor of that borrower;<sup>54</sup> yet, this is a method of collection of the debt owed by a borrower to his lender, enforceable by court order. It is not a voluntary disposition amounting to the transfer of the debtor's debt (owed to the borrower) into the lender's hands, resulting from the borrower's instruction.<sup>55</sup> The prevailing view is that this method of collection is available to a lender only against an impecunious borrower; that is, the lender can recover directly from the borrower's debtor only where it was proven in court that the borrower does not have means to pay,<sup>56</sup> or at least that he has no liquid assets to hand.<sup>57</sup> Stated otherwise, inroads or exceptions to the indispensability of the proprietary act requirement for the transfer of property<sup>58</sup> have not gone as far as to facilitate the recognition in the ownership in, and certainly, not in the voluntary transferabil-

<sup>53</sup> For this distinction between money on deposit and money lent, see Talmud, *Bava Kamma* at 106A. See also Talmud, *Ketuot* at 84A. There is, however, a disputation as to whether money lent that has not been used in full or in part is to be treated as a deposit. See Talmud, *Kiddushin* at 47B–48A.

<sup>54</sup> See Talmud, *Kiddushin* at 15A; *Bava Kamma* at 40b; *Pesachim* at 31A; *Gitin* at 37A; and *Ketubot* at 19A, 82A. The rule is said to be derived from Scriptures, Numbers 5:7, according to which '[he shall] give it to the one to whom he is guilty'.

<sup>55</sup> See summary and sources in Albeck, *The Law of Property*, above n 49 at 579.

<sup>56</sup> To that end, see particularly the Ran, D'H 'le-olam', commenting on the Rif, on Talmud *Ketubot* 19A, at 6A (Rif's page numbering). This lien is provided as a special rule since, as immediately above, the money owed by the debtor to the borrower (even where it is on a documentary note as immediately below) is not a tangible object owned and possessed by the borrower; it is thus not treated as an 'asset' in the borrower's hands available to satisfy the borrower's own debts. Ran, *ibid*.

<sup>57</sup> See *Shulchan Aruch* Choshen Mishpat Section 86, Rules 2–4. For a critical discussion citing plenty of relevant authorities but departing from a strict absolute impecuniousness requirement, see Shach, n 5 in *Shulchan Aruch* Choshen Mishpat Section 86, Rule 2. But even the *Shulchan Aruch* which appears to support the impecuniousness requirement cites an anonymous view according to which the lender can recover money deposited by the borrower with a third party in preference to the alternative of seizing the borrower's land. *Ibid* Choshen Mishpat Section 86, Rules 2 and 4. For the invocation of Rabbi Nathan's lien to support a payment mechanism see E Westreich, 'Elements of Negotiability in Talmudic and Geonic Times' in J Cohen (ed), *Jewish Commercial Law: Essays in Memory of George Weber*, XIX Jewish Association Studies (JALS) (Liverpool: Deborah Charles Publications, 2008), 247 at 252–53 (hereafter: Westreich, 'Negotiability in Talmud').

<sup>58</sup> The indispensability of the proprietary act requirement is discussed above in paragraph containing nn 26–35.

ity by one person to another of, an intangible such as money due on an oral loan;<sup>59</sup> neither a proprietary act nor proprietary language could have affected its disposition.<sup>60</sup>

An exception to the non-transferability of a loan exists where the borrower's duly executed obligation is contained in a documentary note of indebtedness. Indeed, it is recognized that unlike an ordinary chattel, the loan document has no intrinsic value;<sup>61</sup> and yet, the delivery of the document from the lender to another person with the intention to transfer it is a proprietary act, under which the claim to the sum of money due under that document is conferred on that other person, almost<sup>62</sup> as if the document were an ordinary chattel. Interestingly, this practice may have been reminiscent of the transferability of the 'promissory note' in Old Babylonia (2000–1600 BCE),<sup>63</sup> except that the treatment by the Talmud of the practice and its legal aspects is much more detailed and thus more helpful for the understanding of its legal underpinning.

Under the Talmud, to be transferable, a documentary note of indebtedness must be a *shetar*; it thus has to comply with formality requirements,<sup>64</sup> even if

<sup>59</sup> But cf Talmud, *Bava Metzia* at 92B, which appears to recognize the assignability of a worker's benefits claim, though neither as a payment mode nor as a financing technique.

<sup>60</sup> At the same time, money due on an oral loan passes by inheritance (ie, it is transmitted involuntarily by death). See Mishna in Talmud, *Ketuvot* at 84A and Gemara (and Rashi D'H 'Halva-ati le-ploni') in *Bava Batra* at 148A. Later sources are cited in *Talmudic Encyclopedia*, vol 25 (Jerusalem: Yad Harav Herzog, 2002) [in Hebrew], *sv* 'Yerusha' (succession or inheritance) at 199, fn 1004 and 207, fn 1096. See also Gemara in *Bava Batra* at 125B–126A, discussing an inheritance rule as to a debt due to the inheritor, for which Rashi states at 125B, D'H 'Ve-ein habchor' that it applies 'even for a documentary note', thereby implying the rule definitely applies to a debt due on an oral loan. The corresponding heir's obligation to pay the inheritor's debts is discussed in Zevin, SJ (ed in chief), *Talmudic Encyclopedia*, vol 23 (Jerusalem: Yad Harav Herzog, 2002) [in Hebrew], *sv* 'Yoresh' (successor or heir) at 615.

<sup>61</sup> See eg Talmud, *Bava Kamma*, at 62B (dealing with a thief's exemption to pay the double payment for which a thief of an ordinary chattel is liable) and 98A (dealing with loss incurred when a loan document is burnt). Lack of intrinsic value in a loan document is also alluded to eg in Talmud, *Kiddushin* at 9A, 26A and 48A.

<sup>62</sup> The qualification is designed to point out that while *mesira* (delivery) is available for the transfer of a loan document, not all methods for transferring a chattel, such as *hagbaha* (lifting) and *meshicha* (drawing near or pulling), as well as *chalifin* (barter, namely, the exchange of two chattels) are available for acquiring ownership in a loan document. For such modes of acquisition for chattels in general, see Talmud, *Kiddushin* at 25B (as well as 22B) and *Bava Batra* at 84B, as well as *Bava Metzia* at 46A. For the inadequacy of *meshicha* (drawing near or pulling) (and hence the need for physical delivery by the transferor, ie *mesira*) for a documentary note, see eg Talmud, *Bava Batra* at 76A, commentary by both Rashi D'H 'Ve-otiyot bimsira', and Tosafot, D'H 'ly'. For the inadequacy of *chalifin* for the acquisition of a documentary note of indebtedness on a loan, see Talmud, *Bava Batra* at 77, commentary by Tosafot, D'H 'Amar Ameimar'.

<sup>63</sup> For the transferable 'promissory note' in Old Babylonia and the gap in our knowledge as to the law applicable to the transfer, see ch 3, section 2, text around n 37, and more generally, around nn 35–44.

<sup>64</sup> 'Every *shetar*, as a formal document, requires the signatures of witnesses.' Otherwise, an informal unwitnessed document is a mere piece of evidence for an oral contract. See AM Fuss, 'Shetar' in M Elon (ed), *The Principles of Jewish Law* (Jerusalem: Keter, 1975) (Reprinted from *Encyclopedia Judaica*, 1st edn), Columns 183–90 at 184. But according to the Rambam, for a documentary note of indebtedness on a loan (*shetar hov*) manually written by the debtor there are no formal requirements other than as to witnessing. See Rambam, *Mishpatim: Hilchot Malve ve-Love* Section 11, Rule 2, as well as Section 27, Rule 1. Formal debt documents may go back to the Greek *chirograph*

only as to adequate witnessing.<sup>65</sup> Furthermore, there may be formalities to be observed as for the transfer itself. Thus, it is disputed whether by itself, the delivery of the documentary note of indebtedness is adequate to transfer the right to collect the debt<sup>66</sup> or whether, to that end, an accompanying properly executed bill of sale is also required from the transferor-lender.<sup>67</sup> In the footsteps of the transferable debt document, such a bill of sale must be a *shetar*; stated otherwise, it may have to comply with formality requirements, even if only as to witnessing.<sup>68</sup> The transfer-deed requirement continued to be debated in the post-Talmudic era, and ultimately appeared to have prevailed.<sup>69</sup>

Another disputation is as to whether the transfer of the right to collect on a documentary loan forfeits altogether the power of the lender to release the borrower.<sup>70</sup> It seems that, on this point, it was ultimately determined that the power of the lender to release the borrower survives the transfer.<sup>71</sup> Stated otherwise, towards the borrower, the transfer does not override the original power of the transferor-lender to discharge the borrower. Practically, with the renunciation power left in the transferor-lender's hands, the effect of the transfer of the debt is limited to the transfer of the power, or even the giving of a mere authorization

and *syngraph*; however they were not transferable. For these documents see eg F De Zulueta, *The Institutes of Gaius*, Part I: Text with Critical Notes and Translation (Oxford: Clarendon Press, 1946) at 195 and Part II: Commentary (Oxford: Clarendon Press, 1953) at 166.

<sup>65</sup> The Talmud records a disputation as to whether a documentary note of indebtedness (*Shtar Hov*) has to meet witnessing requirements. See Talmud, *Gitin* at 86B. Maimonides upholds witnessing requirements with respect to either the signature of the debtor or the delivery by him of the document to the creditor. See Rambam, *ibid* Section 11, Rules 2 and 3. According to the Magid Mishna commentary to the Rambam, *ibid*, this reflects the majority view among the post-Talmud Rabbis. Delivery witnesses as a replacement for signature witnesses are discussed eg by Rashi, Talmud, *Bava Batra* at 176 D'H 'Vegoveh'. Witnessing requirements are also discussed in Choshen Mishpat Sections 40 and 51 in both *Tur* and *Shulchan Aruch*.

<sup>66</sup> Those satisfied with the power of the mere delivery of the document to transfer the right to collect the debt nevertheless disagree as to whether a transferee, or in fact any person in possession of a documentary note of indebtedness payable to another person, is required to prove title (namely, receipt by way of transfer or by way of gift from the named payee or someone deriving title from him) or suffice it for him to rely on his possession. See Talmud, *Bava Batra*, at 173A.

<sup>67</sup> For the Talmudic discussions, see Talmud, *Kiddushin* at 47B–48A where it is further disputed as to whether, to effect a transfer, the bill of sale (if needed) is required to contain prescribed language. See also Talmud, *Bava Batra* at 75B–77B (with Tosafot at 77A D'H 'Amar Ameimar'), Talmud, *Sanhedrin* at 31A, and Talmud, *Yevamot* at 115B.

<sup>68</sup> Being a legal document, the bill of sale is a *shetar* (for this term, see n 64 and text above); as such it is subject to the same requirements and disputations as the documentary note of indebtedness.

<sup>69</sup> For the shift of position in that direction shortly after the conclusion of the Talmud (ie, during the Gaonic era), see Westreich, 'Negotiability in Talmud', above n 57 at 259–66. For a ruling see: Rambam, *Kinyan: Hilchot Mechira*, Section 6, Rules 10–11; Choshen Mishpat above n 65 Section 66, Rule 1. Cf Rambam, *Mishpatim: Hilchot Malveh ve-Loveh*, Section 16, Rule 7 (in conjunction with the Magid Mishna on the point) discussing evidentiary requirements in circumstances in which the bill of sale has been lost (as well as a plea by the debtor that he has paid to the original creditor). The Rambam appears to dispense with the transferee's need to produce evidence for the transfer when sued by the transferor, but not in suing the debtor who contests the transfer.

<sup>70</sup> *Ibid*. See also Talmud, *Bava Metzia* 20A and *Ketuvot* 85B–86A.

<sup>71</sup> Rambam, *Kinyan: Hilchot Mechira*, Section 6, Rule 12. See also Choshen Mishpat Section 66, Rules 23–24 (also stressing that the power to release may not be effectively contracted out).

to the transferee, to sue the debtor, collect from him, and retain the proceeds. For his part, not only may the debtor meet the transferee's action by asserting defences based on the transaction between him and the transferor-lender; rather he may also raise the defence of payment to and/or release by the transferor-lender after the transfer, even while having full knowledge of the transfer. Nonetheless, between the transferor-lender and the transferee the transfer is binding and effective; where the former exercises the renunciation power against the borrower, the transferee is allowed a recourse against him for damages, as if the transferor-lender burnt a loan document belonging to the transferee.<sup>72</sup>

Experimentation designed to bypass both difficulties, namely that of the transfer deed (or bill of sale) requirement, and the post-transfer original creditor (transferor)'s power to release the debtor, took place in the twelfth–fourteenth centuries in Spain and France.<sup>73</sup> This experimentation involved the use of clauses in documentary notes of indebtedness expressing a promise by the debtor to pay not just the creditor, but rather, either (i) the creditor and 'whoever [he] will later nominate', or (ii) the creditor or 'bearer'. Such clauses correspond to modern negotiable promissory notes and bills of exchange, payable either to 'order' or to 'bearer'.<sup>74</sup> The question with which leading Medieval Rabbinic scholars struggled, was whether such language conferred on a transferee producing the document (i) a right to collect, so as to dispense with the requirement to submit a deed authorizing him to do so, as well as (ii) an independent right, so as to extinguish the release power of the original creditor (the transferor).<sup>75</sup> Results were mixed.

According to the Raavad (in Provence, France), a lender may not release his debtor on a note payable to the lender or his nominee, that has been sold to a nominee; this is so because, upon the sale of the note, the debtor became directly obligated to the nominee.<sup>76</sup> The Rashba (in Catalonia, Spain) was in full agreement,<sup>77</sup> but only as long as the nominee had been born prior to the original issue of the note to the lender.<sup>78</sup> As well, the Rashba allowed a transferee of a

<sup>72</sup> Rambam, *ibid* (Magid Mishna) and *Nezikin: Hilchot Chovel U-Mezik*, Section 7, Rule 9. See also Choshen Mishpat Section 66, Rule 32.

<sup>73</sup> For a thorough analytical discussion, see E Westreich, 'Elements of Negotiability in Jewish Law in Medieval Christian Spain' (2010), 11 *Theoretical Inquiries in Law* 411 (hereafter: Westreich, 'Negotiability in Spain'). For a broader historical and geographical perspective, see AM Futh, 'Assignability of Debt and Negotiable Instruments in Jewish Law' (1984–85), 12 *Diné Israel* 20 and JJ Rabinowitz, *Jewish Law: Its Influence on the Development of Legal Institutions* (New York: Bloch, 1956) 334–51.

<sup>74</sup> *The Bills of Exchange Act, 1882* (UK) 45 & 46 Vict., c. 61, s 8(2).

<sup>75</sup> The question of full or material negotiability, ie, the taking of the note free from the debtor's defences and third parties' claims, was not even discussed yet. For material negotiability see ch 11, section 6 below.

<sup>76</sup> YD Kapach (ed), *Responsa Raavad*, (Jerusalem: Rav Kook Institute, 1964) §§ 141 (last paragraph) and 181 [in Hebrew].

<sup>77</sup> Rashba, D'H 'Vechatav HaRaavad' commenting on Talmud, *Gitin* at 13B; *Responsa Rashba* (Jerusalem, Masoret Yisroel, 2000) Part 2 § 311, Part 3 § 20, Part 5 § 117 [in Hebrew].

<sup>78</sup> *Responsa Rashba, ibid* Part 2 § 311. For the inability to confer rights on the unborn, see n 134 and text around it, discussing the same argument in connection with instructing a paymaster 'in the presence of all three', to which the discussion by the Rashba on the nominee and bearer clauses is

bearer note, who had been already alive at the time of the issue of the note to the transferor-lender, to sue the debtor without producing a deed of transfer or authority from the original lender.<sup>79</sup> Rashba specifically spoke of the effect of the bearer clause to generate a direct liability of the debtor to the bearer, created upon the transfer of the document to him; thereby Rashba appeared to disapprove of the post-transfer renunciation power of the original lender.<sup>80</sup> Arguably then, according to the Rashba, each clause, whether to a nominee or bearer, achieves both results, namely, that of forfeiting the post-transfer release power of the transferor-creditor, and eliminating the transfer deed requirement for effectuating the transfer of the indebtedness-note.<sup>81</sup>

Insisting on the requirement of a sale or gift from the original creditor to the bearer,<sup>82</sup> the Rashba ruled out any notion of material negotiability, that is, the ability to acquire a good title free from claims and defences; and yet, he appears to establish procedural negotiability, under which title to a debt instrument passes upon delivery from a rightful possessor.<sup>83</sup>

Rosh (in Castile, Spain) was not ready to go that far. Indeed, he was prepared to dispense with the transfer deed requirement for a transferee of a note payable to bearer.<sup>84</sup> At the same time, he said, this is the entire effect of the bearer clause;<sup>85</sup> thereby Rosh suggested that the bearer clause lacks the power to override the release power of the original creditor (transferor). Furthermore, specifically rejecting the Raavad,<sup>86</sup> and thus disagreeing with the Rashba,<sup>87</sup> the Rosh ruled that a lender may release the debtor on a note payable to the lender or his nominee, even after the sale of the note to the nominee.<sup>88</sup> Effectively then, he recognized the standing of the bearer to collect but not the independence of his right. He certainly rejected any notion of an independent right in the hands of the transferee of a note payable to the creditor or his nominee. As well, he did not rule on the dispensation of a deed of transfer for such a document.

In any event, whether or not a bill of sale (deed) is required to 'perfect' the transfer of a debt document (not necessarily containing a nominee or bearer clause), it is undisputed that in conjunction with the physical delivery<sup>89</sup> of a

specifically linked. Inasmuch as the law in relation to 'the presence of all three' is a law for which there is no rationale see discussion around n 132 below.

<sup>79</sup> *Responsa Rashba*, *ibid* Part 1 § 921 (as well as § 970).

<sup>80</sup> *Ibid* § 970.

<sup>81</sup> This is also the conclusion of Westreich, 'Negotiability in Spain', above n 73 at 422.

<sup>82</sup> *Responsa Rashba*, above n 77 Part 1 § 970.

<sup>83</sup> For procedural and material negotiability see below, ch 11, section 6.1.

<sup>84</sup> YS Yudlov (ed), *Responsa Rosh*, rev edn (Jerusalem, Ezer Hamishpat, 1994) Rule 68 § 7 [in Hebrew].

<sup>85</sup> *Ibid*.

<sup>86</sup> As explained in text around n 76 above.

<sup>87</sup> As explained in text around n 77 above.

<sup>88</sup> *Responsa Rosh* above n 84, Rule 69 § 1.

<sup>89</sup> Even commentators who are satisfied with 'constructive delivery' for ordinary chattels (eg Tosafot, D'H 'Behema' commenting on Talmud, *Kiddushin* at 25B) insist on the physical (or actual) delivery (from hand to hand) for a documentary note (eg Tosafot, D'H 'Iy' commenting on Talmud, *Bava Batra* at 76A).

debt document from a creditor-lender to a transferee, and without requiring the consent of the borrower, that is, the obligor of the debt, the Talmudic sages uphold the transferability of the right to collect from the obligor-borrower on the debt document. It further appears that no recourse is available to the transferee against the original lender, as long as the latter has not released the borrower; that is, the sale of the documentary note and hence of the loan-debt recorded on it is in absolute (and not conditional) payment of the debt owed by the transferor-lender to the transferee.<sup>90</sup> Indeed, as indicated, upon the release of the borrower by the lender, the transferee's recourse is theorized as a claim for damages, namely, for loss caused by the release, rather than on the revival, of the original debt between them.

By way of a brief recap, transferability is limited under Talmudic law to a documentary note of indebtedness. In contrast, an oral loan is not transferable. A transferable note must be a *shetar*, complying with formality requirements, even if only as to adequate witnessing. Mode and full effect of transferability is debated. A loan evidenced by a written document not complying with formal requirements, so as not to be a *shetar*, is therefore 'oral.'<sup>91</sup> A reference merely to a loan or money lent, without any mention of a documentary note of indebtedness or any equivalent, is to money lent under an oral loan (which is not transferable).

### 2.3 Transfer of Money Owed by Authorizing the Creditor to Collect from the Paymaster: The *Urcheta*

The *urcheta* is a written and properly witnessed authorization given by a creditor to an emissary, turning him into an agent<sup>92</sup> with the power to collect from the creditor's debtor money or chattel owed by that debtor to the creditor.<sup>93</sup> It is drafted to confer on the emissary both the power to give an effective discharge to the debtor and the power to enforce payment against him; it may further purport to convey to the emissary ownership in the proceeds collected in the execution of his authority.

In our setting, the *urcheta* is issued by the debtor, being the creditor of the paymaster, to his (the *urcheta* issuer's) own creditor. It authorizes the *urcheta* issuer's creditor to act as an emissary for his debtor, the *urcheta* issuer, and collect money from and enforce payment against the paymaster, and thereupon

<sup>90</sup> Nevertheless, for the connection between the power to release and conditional discharge in the case of the disposition of an oral loan (rather than a documentary note), cf discussion in text around nn 156–69 below.

<sup>91</sup> An informal, unwitnessed document is a mere piece of evidence for an oral contract. See Fuss, above n 64 at 184.

<sup>92</sup> For a modern perspective on agency in Jewish law, see monograph by S Ettinger, *Agency in Jewish Law in Comparison with Agency Law*, 1965 (Jerusalem: Institute of Research in Jewish Law, 1999) [in Hebrew].

<sup>93</sup> For a more detailed explanation, see Zevin, SJ (ed in chief), *Talmudic Encyclopedia* (Jerusalem: Yad Harav Herzog, 1965) [in Hebrew] vol 11 at 15 sv 'Harsha-a' (authorization).



give the paymaster a discharge vis-a-vis the *urcheta* issuer. The *urcheta* further purports to authorize the emissary (creditor of the *urcheta* issuer) to keep the proceeds collected from the paymaster in discharge of the debt owed by the *urcheta* issuer to the emissary.

To give the emissary the power to enforce payment, namely, to bring a court action against the paymaster, the *urcheta* must be drafted so as to convey a proprietary right to the emissary in the subject matter to be collected; otherwise, the emissary-creditor's action against the paymaster for the money or chattel owed to the debtor (the *urcheta* issuer) will be dismissed for lack of standing to sue.<sup>94</sup> This proprietary effect also renders the authorization irrevocable so as to secure the effective power of the agent to give a discharge.<sup>95</sup>

The Gemara records **two disputations, one on the scope and the other on the effect of the *urcheta***.<sup>96</sup> The first disputation is whether the *urcheta* may be given by the issuer-debtor to the emissary-creditor with respect to the collection of money lent to, and not only deposited with, the paymaster. Assuming a positive reply, on that point it is further disputed whether, with respect to money lent by the debtor-issuer to the paymaster, the creditor may enforce payment against the paymaster or only has the power to give him an effective discharge upon a voluntary payment. The second disputation is as to the effect of the *urcheta* to pass to the emissary-creditor ownership in the money he collected from the paymaster, so as to apply it in the discharge of the debt owed to him (the emissary-creditor) by the debtor (the *urcheta* issuer).

**The first disputation** is as to whether the *urcheta* is effective in connection with a debt owed by the paymaster to the debtor-issuer for money lent and not only for a debt owed by the paymaster for money on deposit. To that end, two versions, both attributed to the scholars of Nehardea, are put forward.

Under **the first version of the first disputation**, an *urcheta* is not to be written for chattels that are not in the *urcheta* issuer's own legal possession or otherwise in his domain. The explanation given is the lack of ability to transfer property in anything which is neither owned nor possessed by the transferor.<sup>97</sup> Indeed, according to the Rashba, an effective *urcheta* requires an actual act of *kinyan*, and not mere language in the document, conferring on the emissary a proprietary right.<sup>98</sup> This excludes chattels stolen from the owner's possession, which

<sup>94</sup> But note the view of the Maor Ha-Gadol, commenting on the Rif on Talmud, *Bava Kamma* at 27B (of Rif's page numbering), who understands Rav Ashi, in the language mentioned in n 97 below, to argue not with Ameimar but rather with the view that a proprietary right must be conveyed.

<sup>95</sup> This appears to satisfy Shmuel's concerns. See last paragraph in section 2.4 below.

<sup>96</sup> Talmud, *Bava Kamma* at 70A. The discussion which follows here does not set out the Talmudic discussion in the original sequence, but rather, as required for the understanding of the questions under discussion. A modern discussion on the Gemara text is by B Lifshitz, 'Authorization and Agency' (1999–5759), 58 *Tarbitz* 1.

<sup>97</sup> To that end, Ameimar quotes to Rav Ashi the explanation of Rabbi Yochannan according to which neither a thief nor the owner can consecrate a stolen object; the thief because the object is not his, and the owner because the object is not in his possession. For another implication of this point, see above, text around n 31.

<sup>98</sup> Rashba commenting on Talmud, *Bava Kamma* at 70A.

remain owned but not possessed by the owner. Equally excluded from one's property is money lent by him; having been given to the borrower, money lent is neither owned nor possessed by the lender, and as such may not be transferred by him.

However, Tosafot points out that there is nothing to preclude an effective *urcheta* with respect to chattels deposited with a custodian, since the legal possession in them is deemed to be in the depositor-owner's hands, who thus has both ownership and possession.<sup>99</sup> This logic equally applies to the deposit of money; hence the depositor may issue an *urcheta* authorizing the emissary to collect from a custodian a deposit of money. Conversely, this logic is not broad enough to allow a lender of money to issue an *urcheta* authorizing the emissary to collect from the borrower.

*The second version of the Nehardeans' ruling on the first disputation* does not require affected chattels to be in the legal possession, or in the domain, of the *urcheta* issuer. Rather, under the second version, no *urcheta* is to be issued over chattels with respect to which the person alleged to owe them denies liability; in any other case, according to the second version, an *urcheta* may be issued irrespective of whether affected chattels are in or outside the legal possession, or in the domain, of the *urcheta* issuer. Rashi explains that this limitation, or exclusion of chattels with respect to which the person alleged to owe them denies liability, applies only to an earlier denial of liability, made by that person in court, in a proceeding brought against him by the *urcheta* issuer.

The Gemara goes on to explain that an *urcheta* purporting to convey a proprietary right in a chattel with respect to which liability is denied is ineffective since it has the appearance of falsehood. However, subsequent commentators stated that the exclusion of chattels with respect to which the person alleged to owe them denies liability had not been honoured, either because of lack of concern as to its rationale,<sup>100</sup> or in order to prevent its abuse.<sup>101</sup> Yet in the view of the Rambam this limitation is still valid.<sup>102</sup> Effectively, then, other than according to the Rambam, under the second version, an *urcheta* may be issued irrespective of whether affected chattels are in or outside the legal possession, or in the domain, of the *urcheta* issuer, even where the person alleged to owe them denies liability. Stated otherwise, an *urcheta* may be issued with respect to money, whether lent or deposited, even where the paymaster denies liability.

*Final ruling as to the first disputation*, that relating to the scope of the *urcheta*, is according to the second version of the Nehardean scholars.<sup>103</sup> This version

<sup>99</sup> Tosafot, D'H 'Lo' commenting on Talmud, *Bava Kamma* at 70A. 'Tosafot' is to mean Tosafot's editor.

<sup>100</sup> See, eg, Tosafot, D'H 'A-metaltelin' commenting on Talmud, *Bava Kamma* at 70A.

<sup>101</sup> Rashba commenting on Talmud, *Bava Kamma* at 70A.

<sup>102</sup> Rambam, *Kinyan: Hilchot Sheluchin*, Section 3, Rule 6.

<sup>103</sup> To that end, Tosafot relies on the fact that elsewhere in the Gemara, namely, Talmud, *Shevuot* at 33B and *Bechorot* at 49A, it is only the second version that is mentioned. Tosafot, D'H 'A-metaltelin' commenting on Talmud, *Bava Kamma* at 70A. See also Rif commenting on Talmud, *Bava Kamma* at 27A–27B (of Rif's page numbering).

does not require affected chattels to be in the legal possession, or in the domain, of the *urcheta* issuer. There is close to universal agreement, not shared by the Rashba,<sup>104</sup> that the second version does not require an act of *kinyan* so that, under the second version, the *urcheta* may be effective also for stolen property as well as for money lent by the *urcheta* issuer to his debtor (that is, the paymaster in our setting). According to the Rambam, however, where a proprietary interest cannot be conveyed, as for example for money lent, the effect of the *urcheta* is rather limited; it merely gives the emissary the power to give discharge to a paymaster who pays him willingly, yet it does not empower the emissary to enforce payment by taking a reluctant paymaster to court.<sup>105</sup>

Most commentators are of an opinion contrary to that of the Rambam; rather, they maintain that the second version of the Nehardeans compels that, even with respect to a loan, the effect of the *urcheta* is to empower the emissary-creditor not only to give effective discharge, but also to take the paymaster to court and enforce payment against him. The explanation given is the primary nature of the *urcheta* as an authorization to collect, coupled with a conveyance of a proprietary right, even if solely for the limited purpose of allowing the emissary the standing to sue the paymaster.<sup>106</sup>

To summarize the position with respect to the first disputation, according to the view of the Rashba, so far as money owed by the paymaster is concerned, the *urcheta* is effective only for the return of money deposited by the issuer-debtor with the paymaster. Conversely, the overwhelming contrary view is that the *urcheta* works also for the collection of money lent by the issuer-debtor to the paymaster. The Rambam shares the majority view, under which the *urcheta* is effective with respect to money lent by the issuer-debtor to the paymaster; and yet, in such a case, as opposed to the case of money deposited by the issuer-debtor with the paymaster, the Rambam would limit its effect to the power to give discharge and not to enforce. As well, departing from the majority view, the Rambam would regard the *urcheta* to be ineffective when the paymaster denies liability.

**The second disputation** is as to the effect of the *urcheta* to pass to the emissary ownership in the proceeds he collected from the debtor; in our setting, the disputation is then with respect to the effect of the *urcheta* to pass to the emissary-creditor ownership in the money he collected from the paymaster, so as to apply it in the discharge of the debt owed to him (the emissary-creditor) by the debtor (the *urcheta* issuer).

On this point, Ameimar argues that, on the basis of the proprietary right conveyed to him by the *urcheta* issuer, the emissary may keep to himself the proceeds he collected from the paymaster. Conversely, Rav Ashi points out that the *urcheta* issuer states in the *urcheta* that he accepts upon himself all expenses

<sup>104</sup> Rashba commenting on Talmud, *Bava Kamma* at 70A.

<sup>105</sup> Rambam, *Kinyan: Hilchot Sheluchin*, Section 3.

<sup>106</sup> Particularly see Nimukei Yoseph and Milcahmot on the Rif commenting on Talmud, *Bava Kamma* at 27A–27B (of Rif's page numbering).

incurred on account of the litigation.<sup>107</sup> On this basis, Rav Ashi maintains, it is obvious that the *urcheta* issuer appointed the emissary as a mere agent for collection and is therefore empowered to claim from him the proceeds so collected. Under another version, Rav Ashi concedes passage of ownership to the emissary on the basis of the conveyance of a proprietary interest, but argues, again on the basis of the *urcheta* issuer's undertaking to cover all expenses, that this is only transfer of co-ownership, so that the *urcheta* issuer is not taken to divest himself of the entire proprietary right.

In connection with this second disputation, the final ruling of the Gemara sides with Rav Ashi's first view. Thereunder, the *urcheta* issuer appoints the emissary as a mere agent who, notwithstanding the language in the document conveying to him a proprietary right in the money collected from the paymaster, cannot retain it for his own use;<sup>108</sup> that is, the emissary-creditor cannot apply the proceeds in satisfaction of the debt owed to him by the *urcheta* issuer.

In the final analysis, however, it is not disputed that the effect of the *urcheta* is to give the emissary a truly proprietary right in the proceeds, albeit only between collection from the paymaster and remittance of the *urcheta* issuer. In the hands of the emissary, this proprietary right is thus limited both in time and in scope.

As for time, it commences only upon collection from the paymaster; until then the emissary's authority to collect from the paymaster may be revoked by the *urcheta* issuer. Stated otherwise, the emissary's proprietary right is in the money in his hands, once collected, and not in the money while it was owed (by the paymaster to the *urcheta* issuer). On the other hand, the emissary's proprietary right in the proceeds collected by him from the paymaster does not supersede the emissary's obligation to account for and remit them to his principal, the *urcheta* issuer. This is so notwithstanding the debt owed by the *urcheta* issuer to the emissary. Thus, the emissary's proprietary right in the proceeds he received from the paymaster lasts only until the actual payment the emissary is obliged to make to the *urcheta* issuer for whom collection from the paymaster (owing to the *urcheta* issuer) was made. The emissary's proprietary right thus lasts solely between collection from the paymaster and payment to the *urcheta* issuer.

As for limited scope, between these two points of time, that is, between collection from the paymaster and remittance to the *urcheta* issuer/principal, collected proceeds are held by the emissary as if given to him by the *urcheta* issuer/principal by way of either loan or gift conditional on return;<sup>109</sup> the

<sup>107</sup> The original is however not unequivocal; the translation here follows the Rambam, *Kinyan: Hilchot Sheluchin*, Section 3, Rule 1 and Shulcahn Aruch, *Choshen Mishpat*, Section 122, Rule 6. However, in the view of Meiri, D'H 'Kol shékatavnu' commenting on Talmud, *Bava Kamma* at 70A, what the creditor accepts is the outcome of the litigation, not its expenses. Yet, in any event, either interpretation supports Rav Ashi.

<sup>108</sup> According to the Bach (in Talmud, *Bava Kamma* at 70A) this is a later addition to Talmudic account – that nevertheless became part of the text.

<sup>109</sup> A gift on a conditional return is a present that is given to an individual on the condition that the individual will return the present at a later time. This is found, eg, in Talmud, *Kiddushin* at 6B.

emissary may thus not apply these proceeds in satisfaction of the debt owed to him by the *urcheta* issuer.

With respect to the two disputations, the prevailing view is then that, as against the paymaster, the *urcheta* is adequate not only to authorize the emissary to give discharge but also to enforce payment, and not only for money on deposit but also for money lent. At the same time, under the *urcheta*, the emissary may not obtain ownership in proceeds collected from the paymaster, so as to give a discharge to the *urcheta* issuer for the debt the latter owes to the emissary. In the final analysis, in our scenario, the *urcheta* is thus an ineffective mechanism for the transfer (to the creditor) of money owed (by the paymaster to the debtor/*urcheta* issuer).

## 2.4 Transfer of Money Owed by Turning the Creditor's Agent to a Paymaster: The *Dyokani*

According to the Mishna in *Bava Kamma*, a debtor is obligated to seek out his creditor and is not discharged until he makes full payment to the creditor. Stated otherwise, only the creditor himself is empowered to give a discharge; the debtor 'may not [pay] to [the creditor's] son nor to [the creditor's] agent'; rather, the debtor is required to pursue the creditor in person even to a faraway country.<sup>110</sup>

The plain meaning of that text does not preclude the debtor from entrusting money with his own agent, instructing him to deliver it to the creditor in person. Indeed, since 'a person's agent is like himself',<sup>111</sup> it is obvious that the remittance of the money earmarked for the payment of the debt by the debtor to the debtor's own agent will not suffice to discharge the debt owed to the creditor. The debtor's agent is to be considered in such a case as a custodian to the debtor, liable to him for the deposited money under the law of custody;<sup>112</sup> yet, the debtor's debt owed to the creditor remains unpaid until money is delivered to the creditor.

At the same time, it is precisely the same principle, namely, that 'a person's agent is like himself', which begs the question as to why, per the quoted Mishnaic language, payment or remittance to the creditor's agent will not discharge the debtor's debt to the creditor.

The discussion that follows in the Gemara,<sup>113</sup> however, demonstrates that for most sages the question addressed by the Mishna is not the power of an agent to

<sup>110</sup> Talmud, *Bava Kamma* at 103A. Strictly speaking, this Mishna deals with payment by a robber or tortfeasor who wishes to repent. It is, however, not to be so narrowly read, but rather it is to apply equally to the discharge of any monetary liability.

<sup>111</sup> Talmud, *Kiddushin* at 41B. See also Talmud, *Bava Metzia* at 96A.

<sup>112</sup> As discussed in section 2.1 above. Whether he is a paid or unpaid custodian depends on the specific facts of each case.

<sup>113</sup> For our purposes, there are two relevant disputations. First, at Talmud, *Bava Kamma* at 104A, there is the Rav Chisda-Rabbah disputation on the adequacy of the appointment of the agent in the presence of two witnesses. Second, at Talmud, *Bava Kamma* at 104A–104B, there is the disputation between Shmuel and Rabbi Yochanan as to the adequacy of remittance by means of a properly witnessed *dyokani*. Shmuel's overall position could be surmised from his position in the second disputation.

give a discharge on behalf of his principal, the creditor. Rather, the issue is whether an emissary with whom money has been deposited by a debtor is truly the creditor's agent with full authority to give a discharge, and not a mere courier suggested by the creditor, who (even if otherwise acting as the creditor's agent) is treated as having received the money from the debtor as the debtor's own agent and custodian.<sup>114</sup> Or else, the issue pertains to the authority of the emissary nominated by the creditor to whom the debtor paid, namely to the scope of his agency for the creditor, as manifested by the manner of his appointment. From this perspective, the Mishna in *Bava Kamma* precludes a discharging payment by the debtor to the creditor's agent only to the extent that the agent is not given by the creditor a specific authority to give a discharge, as reflected in the manner the agent is appointed. In fact, it does not matter whether a custodian who is not properly appointed does not act at all as an agent for the creditor, or whether he has some authority as an agent, other than the power to give a discharge; so far as he is not properly appointed, the custodian lacks the power to give the discharge, and thus is not to be treated as the creditor's agent in relation to the risk of loss of the money in transit.

It is thus not contested that between receipt of money from the debtor and its delivery to the creditor in person, with respect to the money deposited with him, a properly appointed emissary acts as a custodian and agent for the creditor, and not for the debtor. Conversely, and this is the scenario of which the Mishnaic text in *Bava Kamma* speaks, an emissary who is not a properly appointed agent is to be considered as a mere courier designated by the creditor, who is recommended by the creditor to be reliable. The delivery of money by the debtor to this emissary is nevertheless at the debtor's risk; the emissary will be regarded as the debtor's agent and custodian; delivery to this emissary by the debtor is delivery by the debtor to his own agent, so that the debtor's debt to the creditor will not be discharged until the money is handed over by the emissary to the creditor.<sup>115</sup>

Either way, the debtor delivers money to the emissary instructing him to discharge the debt the debtor owes the creditor. Upon receiving the money from the debtor, the emissary becomes indebted to the debtor. However, it is only the properly appointed emissary who can give discharge to the debtor; upon giving the debtor the discharge on behalf of the creditor, the properly nominated creditor's agent, with the authority to give such a discharge, becomes a custodian

<sup>114</sup> For the creditor's agent acting in a specific case as the debtor's agent, see also Talmud, *Bava Metzia* at 98B (Mishna dealing with the lender of a cow sending, with his agent, the cow to the borrower. In fulfilling the loan obligation under the cow loan transaction, the lender is the debtor and the borrower is the creditor). This Mishna is discussed in the Gemara in Talmud, *Bava Kamma* at 104A. In turn, in his Commentary to that Mishna, Rashi refers to the Gemara in *Bava Kamma* at 104A.

<sup>115</sup> In fact, in the footsteps of Talmud, *Bava Metzia* at 76A–76B, the distinction is between an agent for *acceptance*, which can be nominated only by the creditor, and an agent for *delivery*, that can be nominated only by the debtor (though possibly at the recommendation of the creditor). In our case, between the creditor and debtor, each assumes the responsibility for the money while in transit at the hands of his respective agent.

indebted to the creditor.<sup>116</sup> In the process, and as long as the emissary was properly appointed by the creditor, money owed by the emissary to the debtor thus becomes owed by the emissary to the creditor. Upon receiving the money from the debtor and giving him a discharge, the properly appointed emissary thus becomes a paymaster who is not only instructed by the debtor to pay to the creditor but who thereby also owes the money to the creditor.

There is, however, controversy as to what constitutes a proper appointment. Rav Chisda is of the view that an agent appointed by the creditor in the presence of witnesses, presumably on an *urcheta*, is a legally empowered agent, authorized to give discharge on behalf of the creditor, his principal; delivery of the money by the debtor to him discharges the debtor's debt to the creditor. Rabbah is quoted to disagree; possibly he is even more stringent as, in his view, such a duly appointed agent may give discharge on behalf of the creditor only as long as the creditor specifically instructed the debtor to pay that agent.

A third position, that of Rabbi Yochanan, is not fully clear; he is of the view that an agent appointed by the creditor in a letter containing a *dyokani*, namely, an identifying symbol, possibly a seal,<sup>117</sup> may equally give discharge on behalf of the creditor, as long as witnesses authenticated the identifying symbol in the creditor's letter. According to Tosafot, such a letter is to be addressed to the debtor.<sup>118</sup> Tosafot is further of the view that Rabbi Yochanan's position holds true even if the agent has not been appointed in the presence of two witnesses,<sup>119</sup> a view which is contested by Rashba.<sup>120</sup> Thus, according to Tosafot, in dispensing with the witnessed appointment of the agent, Rabbi Yochanan has the most lenient position. Conversely, according to Rashba, in requiring the witnessed *dyokani* on top of the witnessed appointment requirement, Rabbi Yochanan is the proponent of the most stringent position.

A fourth position is that of Shmuel, who categorically states that money is not to be remitted to an agent appointed by the creditor in a letter containing a *dyokani*.<sup>121</sup> He goes on to hold that the payment by the debtor to the creditor's

<sup>116</sup> Certainly, breaking the process down into two stages, as in the text, is the legal perspective on what in fact is most likely one act, namely, the delivery of the money by the debtor to an authorized agent of the creditor, who upon receiving it, implicitly gives the debtor a discharge on behalf of the creditor.

<sup>117</sup> See eg Rashi, D'H 'Be-dyokani' commenting on Talmud, *Bava Kamma* at 104B. For the *dyokani* as a drawing of a form, shape or figure ('*tsura*') see eg Talmud, *Bava Metzia* at 115A. For a modern discussion putting forward the view that the *dyokani* is by reference to personal or physical features describing and identifying the agent, see Y Ostranzer, 'The Dyokani in Legal Documents' (1950), 11 *Tarbiz* 39 [in Hebrew]. For the *dyokani* in the post Talmudic period, see section 4 below.

<sup>118</sup> Tosafot, D'H 'Ein' commenting on Talmud, *Bava Kamma* at 104B.

<sup>119</sup> Tosafot, D'H 'Ve-Rabbi' commenting on Talmud, *Bava Kamma* at 104B. Stated otherwise, according to Tosafot, Rabbi Yochanan is of the view that either witnessed nomination or witnessed *dyokani* will suffice to constitute the emissary as an agent empowered to give discharge on the creditor's behalf.

<sup>120</sup> Rashba, D'H 'Amar Rav Yehuda' commenting on Talmud, *Bava Kamma* at 104B.

<sup>121</sup> On this point, namely the disputation between Shmuel and Rabbi Yochanan, see the Rif on Talmud, *Bava Kamma* at 37A (of Rif's page numbering). The Rif is followed (somewhat reluctantly) by the Rosh, D'H 'Amar Rav Yehuda' commenting on Talmud, *Bava Kamma* at 104B. Both the Rif and the Rosh side with Shmuel, while the Rashba (*ibid*) follows Rabbi Yochanan.



agent, even against a receipt pre-signed by the creditor, is at the debtor's peril, namely, it may not always serve as effective discharge. His stated concern is the effect of the creditor's death occurring between the appointment of the agent and the payment to him by the debtor.<sup>122</sup> To a large extent he is concerned with the revocability of the agency as, presumably, the agent's authority ceases to exist upon the unilateral termination of the agency by the principal, so that a debtor paying in good faith to a properly appointed agent whose appointment has nevertheless been revoked in the meantime is not protected.<sup>123</sup> Unlike the other sages, Shmuel's concern is not the adequacy of the appointment but rather the continued status of the agent, namely, the irrevocability of the agency. The other sages do not argue on that point and do not seem to be concerned with it.

## 2.5 Summary

This section explored various mechanisms for the transfer to a creditor of ownership in money owed by a paymaster to a debtor, whether on a loan or deposit. All such mechanisms require the creditor's consent. Mechanisms discussed fall into two categories. First, the section dealt with mechanisms existing in the broader context of the transfer of property under the Talmud. These are *zechi*, *oditta*, and transfer by dint of land. Second, specialized techniques considered in the section are the *urcheta* and *dyokani*.

In conclusion, a depositor may effectively transfer ownership in a deposit of money by means of a transfer by dint of land, *zechi*, and *oditta*. Among those only *zechi* requires a voluntary act, and hence co-operation, by the custodian/paymaster. In any event, neither *zechi* nor *oditta* facilitates a smooth mechanism for the transfer of the money owed, as each requires some formality; *zechi* in the form of a proprietary act and *oditta* in the form of a witnessed document. *Oditta* is anyway disfavoured, and transfer by dint of land looks cumbersome and inappropriate for transactions in the marketplace.

In contrast to a depositor, a lender may not transfer ownership in money lent other than where the borrower's duly executed obligation is contained in a documentary note of indebtedness. In such a case, the physical delivery of the document from the lender to another person with the intention to transfer, either with or without an accompanying bill of sale properly executed by the lender, transfers the right to collect the debt.

<sup>122</sup> Talmud, *Bava Kamma* at 104B. Indeed, the Mishna, quoted in text at n 94 above, continues to state that, where the creditor dies, the debtor is to pay to his heirs. Hence, prima facie, after the creditor's death, payment to the creditor's agent, rather than to the creditor's heirs, may not discharge the debt.

<sup>123</sup> See the Tur, *Choshen Mishpat*, Section 222. But cf Shulchan Aruch, *Choshen Mishpat*, Rule 222, who is less categorical on the effect of the revocation of the authority on a third party (such as the debtor in our case) who acted on its basis without knowledge of its revocation. All agree that the agency is irrevocable, in which case the debtor ought not to be concerned with the discharge given by a properly appointed agent, where the principal-creditor conferred on the agent a proprietary interest as discussed in section 2.3 above.

The prevailing view is that an *urcheta*, properly executed, authorizing the *urcheta* issuer's creditor to collect money owed by a paymaster to the *urcheta* issuer and apply the proceeds in satisfaction of a debt owed by the *urcheta* issuer to the creditor, is adequate to confer on the creditor (as an emissary of the *urcheta* issuer) the power to enforce payment against, and not only the power to give discharge to, the paymaster. In the hands of the emissary-creditor, this power to discharge and enforce payment against the paymaster is not only for money owed by the paymaster to the *urcheta* issuer on deposit, but also for money owed by the paymaster to the *urcheta* issuer on a loan. At the same time, the creditor-emissary may not acquire under the *urcheta* ownership in proceeds collected from the paymaster on the debt owed by the paymaster to the *urcheta* issuer, and is thus unable to give a discharge on the debt owed by the *urcheta* issuer to the emissary. Rather, in relation to the proceeds collected from the paymaster, the emissary-creditor obtains a proprietary right of limited scope and duration that does not supersede his obligation to remit the proceeds to his principal, the *urcheta* issuer. Stated otherwise, the *urcheta* is not an effective mechanism for the transfer of money owed.

Finally, a debtor may discharge his debt to a creditor by means of a payment the debtor makes to an agent of the creditor who is authorized to give a discharge on the creditor's behalf; effectively, then, the debtor transfers to the creditor money owed to the debtor by the creditor's agent acting as a paymaster. Having received money from the debtor, a duly appointed agent of the creditor who is authorized to give a discharge on the creditor's behalf, replaces the debtor in being indebted to the creditor. It is, however, disputed as to what constitutes a proper appointment by the creditor of an agent authorized by the creditor to give a discharge to the debtor. It is only a payment to a properly appointed agent by the creditor that is capable of conferring a discharge on the paying debtor.

### 3. INSTRUCTING A PAYMASTER TO PAY THE CREDITOR MONEY OWED BY MEANS OF A PRESENCE-OF-ALL-THREE DECLARATION

The Gemara in *Gitin*<sup>124</sup> quotes Rav Huna to say in Rav's name that if one person instructs another who owes him money to give that money to a third party, that third party thereby acquires the right to that money; this is however true only as long as all three of them are present together at the time the instruction is given. As participants in a mechanism for the discharge of a debt owed by the person who gives the instruction to the third party, these two are, respectively, debtor and creditor; the intermediary, that is, the one who owes the money to the person who gives the instruction, is the paymaster. The debtor thus pays his debt to the creditor by conferring on him the right to the money owed by the paymaster. This mode of acquisition by the creditor of the right to the money owed by the

<sup>124</sup> Talmud, *Gitin* at 13A.

paymaster is known in Talmudic law as '*ma-amad shloshtam*' – in the presence of all three, or presence-of-all-three declaration. Thereunder, the oral instruction, uttered by one party in the presence of the two others, is adequate to confer the right to the money on the third party, without any formal act of acquisition.<sup>125</sup>

This principle is originally introduced in the Gemara in the context of piled up coins, that is, with regard to money owed by a depositary or custodian. Yet, the issue is soon revisited.<sup>126</sup> Rava's view is that the principle is indeed so limited and does not extend to money borrowed; in other words, the paymaster must be a custodian and not a borrower. This view is, however, flatly rejected by Rav, in whose name the principle has been stated in the first place, and who firmly asserts<sup>127</sup> that the principle further extends to money lent to, and is not limited to money deposited with, the paymaster. The point is then confirmed in the Gemara; to that end it cites a Mishnaic text, in the form of a Beraitha, to the effect that the paymaster need not necessarily be a custodian and could be a borrower.<sup>128</sup>

Thus, under that principle, by instructing his borrower or custodian to pay<sup>129</sup> to a third party, a lender or a depositor may confer on that third party a right to obtain payment from the custodian or the borrower. This is so, however, only where all three are present together face to face. In the process, the instruction given in the presence of the two others (i) becomes irrevocable for the instruction giver, namely the lender or depositor, (ii) inures to the benefit of the third party-beneficiary, and (iii) is binding on the borrower or custodian, who thereby becomes a paymaster.<sup>130</sup>

In light of the non-transferability of money lent,<sup>131</sup> this extension to a paymaster-borrower is quite far reaching; the Gemara then proceeds to analyse the reasoning underlying the principle and its extension to money lent. Two explanations are put forward; both are rejected, so that the ultimate conclusion is that the law as to '*ma-amad shloshtam*', at least insofar as it extends to money-lent, is a law for which there is no rationale.<sup>132</sup>

Nevertheless, both rejected explanations play a significant role in ensuing discussions and controversies as to the nature of the right conferred on the creditor

<sup>125</sup> See in general, Albeck, 'Assignment of Debt', above n 35 at 267–77.

<sup>126</sup> Talmud, *Gitin* at 13B–14A.

<sup>127</sup> He is recorded as invoking God's name to support his assertion.

<sup>128</sup> For the transfer of money deposited with a custodian, see text above around nn 44–47.

<sup>129</sup> Money must, however, be due and payable by the paymaster and not to be earned by future performance of the instruction giver, even under a binding contract. See Tur, *Choshen Mishpat*, Section 126.

<sup>130</sup> Rambam, *Kinyan: Hilchot Mechira*, Chapter 6, Rule 8. For the point in time where all of this happens, see below, concluding paragraph of this section.

<sup>131</sup> See above, text accompanying nn 53–60.

<sup>132</sup> In conclusion, Mar Zutra enumerates this law, pertaining to a presence-of-all-three declaration, as one of three matters rendered by the sages as laws handed to Moses from Mt. Sinai, for which no rationale is necessary. See Talmud, *Gitin* at 14A, with Rashi, D'H 'Kehilchata belo ta-ama'.

as well as to whether the right may be conferred on the creditor even without the consent of the paymaster. The arguments, their refutations, and their impact on the determination of relevant issues thus merit discussion.

One reason for the effectiveness of the presence-of-all-three declaration with respect to loans is brought forward by Ameimar. In his view, it is as if the paymaster-borrower told the lender at the time the loan was disbursed to him, 'I am hereby under obligation to you, yourself and whoever you will later nominate.'<sup>133</sup> This reasoning suggests that whoever will be nominated becomes retroactively entitled to the right, as of the moment it arose at the time of the disbursement of the loan. The reasoning is rejected, since the person to be subsequently nominated may not have been born at the time the loan was disbursed. The logic of the rationale would, however, lead to the conclusion that the right was conferred on him, prior to his birth, which is conceptually impossible.<sup>134</sup> What is rejected, then, is the theory disqualifying the unborn at the time of the disbursement of the loan from subsequently becoming entitled under the presence-of-all-three declaration; not the fact that the person nominated as a beneficiary after his birth may have been unborn at the time the presence-of-all-three declaration occurred.

An alternative rationale is then put forward by Rav Ashi. In his view, the effectiveness of the presence-of-all-three declaration with respect to loans is based on the paymaster-borrower's satisfaction or benefit derived from the transformation of the debt.<sup>135</sup> Transformation is from a debt on an old loan in the hands of the original creditor, namely, the lender, to a new loan payable now to a new creditor, namely, the lender's creditor designated by the lender as a beneficiary. It is on the basis of this benefit that the paymaster-borrower resolved to become bound to the new creditor, the lender's creditor. The objection to this rationale is however self-evident. The rationale is premised on the assumption that compared to the payment of the original debt owed to the lender, payment of the transformed debt to be owed to the lender's creditor could be delayed, so as to benefit the paymaster-borrower. Yet, the Gemara points out that this may well depend on the facts of each case; it could well be that the new creditor, namely, the lender's creditor, the beneficiary under the lender's instruction, will be harsher than the lender, and will extract payment from the paymaster-borrower promptly, ahead of what would have been the case had the debt been stayed in the lender's own hands. Hence, Rav Ashi's rationale cannot explain

<sup>133</sup> Or more literally, 'I am hereby under obligation to you, yourself and to *whoever will come under you*.' (Emphasis added.)

<sup>134</sup> Talmud, *Gitin* at 13B. The Gemara goes on to quote Rabbi Meir who agrees that property cannot be conveyed to a person who does not yet exist, namely, to the unborn. Rabbi Meir's position on the point is notwithstanding his leniency on the acquisition of future property, a related point on which he nevertheless argues, contrary to the majority of sages, that a person may sell or otherwise convey title to something which does not yet exist or that he does not yet own. For the majority view, see above n 34 and accompanying text.

<sup>135</sup> For the impact of satisfaction as a mode of either acquisition or binding obligation see Y Friedman, 'Satisfaction and Property in the Talmud' (1972/5732), 3 *Dinney Yisrael* 115 [in Hebrew]. Talmudic sources are eg *Bava Batra* at 173B and *Bava Metzia* at 94A.

how a harsher substituting creditor may acquire rights under a presence-of-all-three declaration.

Thus, each reasoning fails due to being too narrow. Ameimar's reasoning does not appear to explain how a person born after the loan was given can acquire rights once nominated after his birth. Rav Ashi's explanation does not appear to explain how a harsher creditor can acquire rights. Yet, both the unborn and the harsher creditor may become beneficiaries and acquire rights; hence, both reasons fail and the all-three-declaration is stated to be a law without rationale.

**Post-Talmudic sources did not challenge the effectiveness of the presence-of-all-three declaration but raised various issues concerning its requirements and precise impact.** Briefly stated, controversies exist over four principal issues:

1. Is the paymaster's consent required?
2. Does the declaration result in (i) the transfer to the creditor of the debtor's right towards the paymaster, or in (ii) a novation of the paymaster's obligation?
3. Does the declaration extinguish the debtor's power to renounce his right towards the beneficiary? and
4. Upon the paymaster's default, does the creditor have recourse against the debtor?

The *first controversy* has been as to whether the paymaster's consent is needed in order for the declaration to confer a right on the creditor. Stated otherwise, the issue has been as to whether the declaration in the presence of all three works on its own, that is, upon its acceptance by the creditor, or whether it further requires the agreement of, or acceptance by, the paymaster. The *second controversy* has been as to whether the effect of the declaration is to transfer or whether it is to transform the right of the debtor. Stated otherwise, the question has been as to whether the creditor acquires a derivative title to the debtor's right to obtain payment from the paymaster, or alternatively, whether the debtor's right and the paymaster's obligation are extinguished so that a new paymaster's obligation, and a corresponding new right, accrues in the hands of the creditor.

As will be seen below, these two controversies are linked, and their resolution hinges on which theory, whether the one underlying Ameimar's or Rav Ashi's respective explanations, is to be preferred. The issue underlying both controversies is with respect to the theoretical underpinning of the presence-of-all-three declaration. In modern terminology, the question is whether the presence-of-all-three declaration results (i) in a *novation*, namely, the creation of a new obligation of the paymaster in favour of a new creditor, or (ii) in an *assignment* or transfer of the right to the debt owed by him to a new creditor.

There are practical consequences, not discussed in the sources, to the determination of this classification issue. To begin with, under the assignment or transfer theory, the new creditor's right against the paymaster is subject to the paymaster's defences against the assignor, namely, the original creditor of the

paymaster; this is not necessarily the case under the novation theory. At the same time, unlike the assignment, the novation results in the extinction of any securities supporting the debtor's right against the paymaster so as not to pass on their benefit to the creditor.<sup>136</sup>

A *third and lesser controversy* has arisen as to the power of the debtor, over the right conferred on the creditor against the paymaster, particularly, as to whether the debtor (lender to or depositor with the paymaster) may extinguish the right by renunciation. A *fourth controversy* arises as to the discharge of the debt paid by means of the presence-of-all-three declaration; where the paymaster defaults and declines to pay, does the creditor, to whom the paymaster was instructed to pay, have a recourse against his original debtor?

In fact, both the third and fourth controversies are concerned with discharge; the former is a matter of the discharge of the paymaster (towards the debtor-instruction giver, his own creditor, namely, the lender or depositor to the paymaster), while the latter is concerned with the discharge of the debtor, the instruction giver (towards his creditor, namely, the beneficiary of the declaration).

Finally, on the top of these four controversies, a *fifth question* exists, as to the determination of the time of the irrevocability and binding effect of the transaction. However, this point has not been extensively discussed; it nevertheless appears that irrevocability and binding effect may not precede the fulfillment of all prerequisites, as determined in the course of resolving some of the controversies. According to the Tur and Shulchan Aruch, when all requirements are met, the transaction is binding on each party and may not be revoked by any one of them, even if they are still together, in the presence of each other.<sup>137</sup> However, consensus on this point, namely, on irrevocability while they are still all together, may not be universal.<sup>138</sup>

All these five post-Talmudic controversies, concerned with the impact of the presence-of-all-three declaration, exist regardless of whether the debtor is a lender to or depositor with the paymaster. The ensuing discussion elaborates on the four principal controversies outlined above.

As indicated, the first two controversies, relating to the paymaster's consent and the effect of the declaration to either transfer or transform the debtor's right against the paymaster, hinge on which theory, whether the one underlying Ameimar's or Rav Ahi's respective explanations, is to be preferred.

The first controversy is as to the need for the paymaster's consent. Tosafot is of the view that no consent by the paymaster (borrower from or custodian for the debtor) is required to render the presence-of-all-three declaration effective.<sup>139</sup> His

<sup>136</sup> In this context, analogous basic Roman law concepts may be instructive. For *novatio* (the transformation of an obligation to a new one) and *cessio* (debt transfer) in Roman law, see A Berger, *Encyclopedic Dictionary of Roman Law* (Philadelphia: American Philosophical Society, 1953) at 600 and 387, respectively. Differences in consequences in the application of each concept are discussed above in ch 5, particularly in sections 6–9.

<sup>137</sup> Shulchan Aruch, *Choshen Mishpat*, Section 126, Rule 1.

<sup>138</sup> Beit Yoseph, D'H 'Af-al-pi shé-ada-yin' commenting on Tur, *Choshen Mishpat*, Section 126.

<sup>139</sup> Tosafot, D'H 'Gufa' commenting on Talmud, *Gitin* at 13B.

reasoning is premised first on the availability of *zech*i, a mechanism under which the custodian's consent is required, to confer a right to a deposit held by a custodian. According to Tosafot, those who view the presence-of-all-three declaration as limited to a deposit<sup>140</sup> would find the presence-of all-three declaration redundant unless in its operation the custodian's consent is dispensed with, so as to improve on what could anyway be achieved by *zech*i. For the latter to be effective, the paymaster's consent in the form of a voluntary proprietary act is essential. Hence, if the paymaster's consent is dispensed with for a deposit held in his hands as custodian, consent must not be required also for a paymaster-borrower. Tosafot acknowledges that *zech*i does not work to transfer the right to a deposit which is no longer in the hands of the custodian; yet, in his view this would be too rare a case to justify the creation of the presence-of-all-three declaration as a new mechanism, not to mention that, according to Tosafot, in such a case, *oditta* would have been available to transfer the deposit.<sup>141</sup>

Tosafot must have been cognizant that *oditta*, which is also available in the more common case of the transfer of a deposit actually held by a custodian, may look more advantageous than the presence-of-all-three declaration; while, like the presence-of-all-three declaration, *oditta* does not require the consent of the custodian, unlike the presence-of-all-three declaration, *oditta* does not require the presence of all three in one place. Tosafot ought then to be taken to disfavour the use of *oditta*, so as to have it invoked only as a last resort, where the presence-of-all-three declaration could not work.<sup>142</sup>

Be that as it may, Tosafot proceeds and brings up a second ground in support of the view that no consent by the paymaster is required to render the presence-of-all-three declaration effective. He thus points out that in the Gemara's account of the Issur Giora case,<sup>143</sup> *oditta* was invoked and a presence-of-all-three declaration could not work, since Rava, the custodian, declined to come to Issur, the depositor. Tosafot explains that Rava declined to come to Issur in order to avoid being forced, by means of a presence-of-all-three declaration, occurring in his presence but against his will, to become liable to pay the deposit, per Issur's instructions, to somebody other than Issur. According to Tosafot, this proves that a declaration by Issur in front of Rava and the beneficiary selected by Issur could have compelled Rava to pay to the designated beneficiary against Rava's will.

Tosafot's reasoning is however challenged by other commentators. They point at the formality required for *zech*i, in the form of a proprietary act, so as

<sup>140</sup> For viewing the application of a presence-of-all-three declaration to a loan (and not only deposit) as disputed (and not settled), see eg Talmud, *Kiddushin* at 48A.

<sup>141</sup> Presumably, in the absence of possession, the custodian will be unable to perform the proprietary act required to transfer ownership of the possession. A custodian may be out of possession where eg the deposited object was stolen from him, or else, where the deposited object is in an area outside his control (such as a cow in the field).

<sup>142</sup> For *zech*i and *oditta* and the discouragement of the use of *oditta*, see above, text around nn 43–47.

<sup>143</sup> Talmud, *Bava Batra* at 149A, discussed above in text around nn 51–52.



to make it an unattractive method to transfer a deposit. They claim that this justifies the establishment of the presence-of-all-three declaration as a more attractive informal method of transfer, notwithstanding Tosafot's reasoning, even if the custodian's consent is not dispensed with. Commentators also point at the language of the Gemara text under which the paymaster is ordered to 'give' money owed rather than to confer ownership in it. This suggests that the declaration becomes effective only upon the voluntary act of the paymaster, which certainly requires his consent; in effect, it puts in question the effectiveness of *zechi* as a method for automatic transfer of title to the money, while it is still in the hands of the paymaster, prior to its actual payment by him to the creditor.

Commentators further dispute Tosafot's explanation of the Issur Giora episode. The alternative explanation to Rava's reluctance to show up before Issur is that Rava could still show up and decline to follow Issur's instruction, but nevertheless was ashamed to openly defy Issur in Issur's own presence. Stated otherwise, according to the alternative explanation, without his own consent Rava was not compelled to follow Issur's instruction, even where it was given in his own (as well as the beneficiary's) presence, except that Rava was embarrassed to go that far and preferred to defy Issur's instructions without confronting him by simply avoiding him.<sup>144</sup>

Subsequent commentators provide alternative analytic explanations as to the theory underlying the presence-of-all-three declaration. It is by reference to such an analytic explanation that the first two controversies are discussed. Stated otherwise, it is by reference to the second controversy, the one concerning the theoretical underpinning of the presence-of-all three-declaration, that the first issue, that of the paymaster's consent, was addressed. Two conflicting views have been put forward. The first follows Tosafot as to the dispensation with the paymaster's consent; proponents of this view further assert that the effect of the presence-of-all-three declaration is to transfer the debtor's right against the paymaster to the creditor. The rationalization of the principle on a rule of law, rather than on the consent of the obligated paymaster, is premised on the common intention of people, or else, on public policy grounds, in order to facilitate commercial transactions and make credit available.<sup>145</sup>

The other view is opposite on both counts. It requires the paymaster's consent to be given in the presence of all three, and further asserts that the effect of the presence-of-all-three declaration, to which the paymaster's consent has been given, is to confer on the creditor a new, novated, and independent right against the paymaster. This view is premised on the strictly personal relation between a debtor and a creditor; in this case, the paymaster and his lender or depositor, so

<sup>144</sup> Ritva, D'H 'Gufa' commenting on Talmud, *Gitin* at 13B.

<sup>145</sup> Rosh, D'H 'Amar Rav Huna' and Raavad, brought by the Rashba, D'H 'Vechatav HaRaavad' commenting on Talmud, *Gitin* at 13B; see also Tosafot, D'H 'Kehilchata' commenting on Talmud, *Gitin* at 14A.

that the beneficial side of that personal relation cannot be transferred to a third person, namely, the beneficiary under the declaration. Nor can it be transformed to a new relationship without the consent of the party obligated, namely, the paymaster.<sup>146</sup>

To a large extent, the former view, that of the transfer of the right without the consent of the paymaster, is concurrent with Ameimar's failed rationale to the all-three-declaration principle, that of the *hypothetical or presumed agreement* by the paymaster. In turn, the latter view, that of the transformation into a new right with the paymaster's consent, draws on Rav Ashi's failed rationale for the principle, that of an *actual agreement* based on the replacement of creditors. And while it is acknowledged that each rationale failed, it is argued that its respective underlying theory has not. Thus, Ameimar's rationale is based on an obligation derived from a rule of law, that is, from an agreement implied or presumed by law; what was rejected is the extension of this rationale to its logical extreme, leading to the failure to explain the acquisition of rights by a beneficiary who was not born at the time of the original loan or deposit.

At the same time, Rav Ashi's explanation is premised on an agreement in fact; what was rejected is the extension of this rationale to its logical extreme, leading to the failure to explain the acquisition of rights by a harsher creditor. In each case, however, it was not the underlying theory that had been rejected. Thus, while each rationale is rejected as not being comprehensive, its respective underlying theory remains effective, so as to guide us in the determination of the first two controversies, namely, that of the paymaster-borrower's consent and that of the transfer or transformation of the right against him.

Of particular interest is the analysis of the Rashba. While siding with the view that the presence-of-all-three declaration works only where the paymaster agrees to comply with the instruction of the debtor, his reasoning does not rest exclusively on Rav Ashi's position but further incorporates Ameimar's rationale. Thus, in the Rashba's view, per Ameimar, the implied undertaking of the paymaster to pay the debtor, acting as the paymaster's lender (or depositor), and whoever is nominated by the debtor, is incurred at the time the loan is disbursed (or deposit is given) to him (the paymaster); however, the implied undertaking is triggered only when the paymaster approves the replacing creditor, namely, upon the paymaster's approval of the substitution of his lender or depositor by the beneficiary of the instruction. Alternatively, at its inception, the implied undertaking is to pay the debtor, and whoever is nominated by the debtor, *as long as the nominee is acceptable to the paymaster*. Furthermore, according to the Rashba, the paymaster's engagement at the time the loan is disbursed (or deposit is given) to him, whether express (per Rav Ashi) or implied (per Ameimar), also runs in favour of a person nominated by the nominee of the debtor.<sup>147</sup>

<sup>146</sup> Ran, D'H 'Mana li' and Ritva D'H 'Gufa' commenting on Talmud, *Gitin* at 13B.

<sup>147</sup> Rashba, D'H 'Amar Rava' commenting on Talmud, *Gitin* at 13B.

In the final analysis, sages who contend that no consent is required rely on neither Ameimar nor Rav Ashi; rather, they adhere to Tosafot's analysis.<sup>148</sup> For them it is adequate to show consistency with the theory underlying Amiemar, that of an implied undertaking by the nominee, and to point out that Rav Ashi's theory, namely, benefit conferred on the paymaster, was anyway rejected by the Gemara. Conversely, sages who require consent rely on Rav Ashi's underlying theory and thus strengthen their position by the Rashba's proposed emendation of Amiemar's underlying theory.

**The third and fourth controversies are concerned with discharge; that of the paymaster towards the debtor as well as that of the debtor towards the creditor.** The third controversy is with regard to the remaining power of the debtor, as the lender or depositor of the paymaster, over the right conferred on the creditor under the all-three-presence declaration. Most commentators are of the view that the debtor, in his capacity as the lender or depositor of the paymaster, does not retain the right of renunciation so that the right conferred on the creditor is fully under the latter's control. The difficulty is the personal nature of the debtor's body liability. Thus, under Talmudic law, the debtor's personal liability to his creditor consists of his body liability and his asset liability; the latter is a lien on the debtor's assets, securing his own body liability. The asset liability may be transferred, so as to empower the transferee to enforce the lien, but only as long as the body liability subsists. Yet, the body liability is strictly personal; it is only the (original) creditor who has the power to renounce the right against the debtor.<sup>149</sup>

Those who do not require the paymaster's consent find the transfer of the entitlement to the paymaster's body liability from the debtor (as a lender or depositor of the paymaster) to the creditor to be one of the unexplained features of the presence-of-all-three declaration.<sup>150</sup> At the same time, those who require the paymaster's consent argue that, according to the principle underlying the presence-of-all-three declaration, the original paymaster's obligation, including its body liability, runs in favour of the debtor and each of his nominees consented to by the paymaster.<sup>151</sup> Thus, adherents of both views as to the first controversy, namely both those requiring and those dispensing with the paymaster's agreement, agree, for their own reasons, that the effect of conferring the right on the creditor is to forfeit the power of the debtor, in his capacity as a lender or depositor of the paymaster, to renounce the right towards the paymaster.

However, consensus on the point is not universal. Thus, the Rambam, who adheres to the former view, dispensing with the actual consent of the paymaster, is of the opinion that the paymaster's body liability remains in favour of the

<sup>148</sup> Above n 139.

<sup>149</sup> A point that also underlies the discussion in Talmud, *Kiddushin* at 47B–48A, where it is stated that the transfer of a documentary note of indebtedness does not pass on to the transferee the power to renounce the debt that remains in the hands of the original creditor.

<sup>150</sup> Rosh, D'H 'Amar Rav Huna' commenting on Talmud, *Gitin* at 13B.

<sup>151</sup> Ran, D'H 'Veika' commenting on Talmud, *Gitin* at 13B.

debtor, namely, the paymaster's original creditor, so that the debtor has not lost his renunciation power notwithstanding the presence-of-all-three declaration.<sup>152</sup> Such renunciation will excuse the paymaster from payment to the creditor to whom he was instructed to pay by the debtor.

**The fourth controversy is that of the discharge accorded, by the all-three-presence declaration, to the debtor towards the creditor – to whom the paymaster was instructed to pay.** Upon the default of the paymaster, one view supports an absolute discharge so that no recourse is available to the creditor against the debtor; the other supports a conditional discharge, so that recourse from the debtor is available to the creditor upon the default of the paymaster.<sup>153</sup>

The starting point in the discussion on the fourth controversy is an extract from the Jerusalem Talmud<sup>154</sup> dealing with the case of a debtor whose creditor agreed to rely on a paymaster for the payment of the debt. It is explained in the Gemara that the debtor instructed the paymaster to pay the creditor whatever the paymaster owed the debtor. The paymaster became impoverished and defaulted, at which point the creditor attempted to obtain recourse from the debtor. Recovery was, however, denied. It was noted though that this is the law as long as the debtor has not 'cunningly' misrepresented the paymaster to be rich while he was not. The Rif cites this text in support of the proposition that in connection with a presence-of-all-three declaration, upon default by the paymaster, and other than in the case where the misrepresentation exception applies, the debtor is absolutely discharged, and no recourse is available to the creditor against him.<sup>155</sup>

A view to the contrary is expressed by Baal Ha-Itur, who is of the opinion that the presence-of-all-three declaration does not discharge the debtor.<sup>156</sup> He explains that the creditor's consent to be paid by the paymaster and to discharge the debtor is revocable so that recourse is available to the creditor against the debtor. He reasons that the debtor retains the power to release the paymaster. In effect he links his reasoning to the conclusion of the minority view, such as that of the Rambam, on the third issue. Indeed, it is hard to see how the debtor retains his power to release the paymaster and still gets an absolute discharge against his creditor, thereby leaving the latter in the cold, with no recourse against either the paymaster or the debtor. Stated otherwise, with respect to the debtor, an absolute discharge (per the fourth controversy) ought to suppose loss of power to release (per the third controversy).

<sup>152</sup> Ramban, D'H 'Bemalvé' commenting on Talmud, *Kiddushin* at 48A. See also the Raavad (mentioned in the text of the Rashba, above n 147) according to whom renunciation power is retained by the debtor where the paymaster has not consented explicitly to the instruction by saying 'I hereby bind myself to you and whoever you will nominate'.

<sup>153</sup> See Shulchan Aruch, *Choshen Mishpat*, Section 126, Rule 9.

<sup>154</sup> Jerusalem Talmud, *Kiddushin*, Section 3, Rule 4.

<sup>155</sup> Nimukei Yoseph, D'H 'Yerushalmi' commenting on the Rif on Talmud, *Bava Metzia* at 68B (of Rif's page numbering).

<sup>156</sup> Baal Ha-Itur, Section 5, 'Hamcha-a'.

The Tur further elaborates on the position of Baal Ha-Itur.<sup>157</sup> He explains the ruling in the Jerusalem Talmud as based on the express release given by the creditor (the beneficiary of the payment order). In his view, in pursuing his recourse from the debtor, who gave the instruction, the creditor, whom the paymaster was instructed to pay, may argue that he agreed to be paid by the paymaster only in order to accommodate the debtor; the creditor has not agreed to discharge the debtor, until he, the creditor, receives actual payment in full. Hence, contrary to the plain meaning of the text in the Jerusalem Talmud and of the Rif, it is only the express release of the debtor by the creditor, and not only the creditor's mere agreement to be paid by the paymaster, that confers an absolute discharge on the debtor.<sup>158</sup> In the absence of an express release, the debtor remains liable to the creditor, though effectively as a mere guarantor of the paymaster, the new principal debtor.<sup>159</sup> In effect, the Tur goes beyond Baal Ha-Itur, as the Tur does not link the conditional release theory to the retention of the power to release. Indeed, the Tur does not deny Baal Ha-Itur's premises according to which those who maintain that the debtor, as the instruction giver, retains the power of release (per third controversy), ought to be taken as permitting recourse against the debtor (per fourth controversy). At the same time, under the explanation of the Tur, the reverse is not true so that the conditional release and hence the availability of recourse (per fourth controversy) stand on their own reasoning, are independent of, and thus are also compatible with, loss of the power to release (per third controversy).

In the final analysis, this fourth controversy is on the impact of the silence of the creditor, namely, the beneficiary of the instruction to pay. The dispute is as to whether the implied discharge given by the creditor to the debtor is conditional or absolute. In fact, what is addressed here, in connection with a scenario in which the paymaster owes money to the debtor, is the same issue discussed at length in chapter four above, in connection with a scenario in which the paymaster extends credit to the debtor. Thus, it is not disputed here that the presence-of-all-three declaration is not effective unless the creditor, to whom the paymaster, who owes to the debtor, is instructed to pay, agrees to accept it. Indeed, it is only logical that a beneficiary under the payment order, who is a creditor of the instruction giver,<sup>160</sup> could not be compelled to have his original

<sup>157</sup> The Tur attributes this opposing view to the Rosh and Baal Ha-Itur. This reliance is however problematic; as indicated by Beit Yoseph in the Tur pages cited in the immediately following footnote, the Rosh (D'H 'Ibaie lehu' commenting on Talmud, *Bava Metzia* at 112A) dealt with a paymaster who does not owe money to the instruction giver which, per discussion in ch 4 above, is a distinguishable situation. At the same time, as indicated in the preceding paragraph, Baal Ha-Itur (also cited by Beit Yoseph) does not go as far as the Tur in his reasoning and hence in the reach of his conclusion.

<sup>158</sup> The Tur, *Chosen Mishpat*, Section 126.

<sup>159</sup> *Ibid.* The Talmudic law of guarantee is discussed in ch 4, section 2.2 above.

<sup>160</sup> Indeed, a presence-of-all-three declaration may also confer rights on the beneficiary by way of gift to him, rather than as means of payment of a debt. See Tur, *Choshen Mishpat*, Section 126. Yet in such a case no recourse is anyway available to the beneficiary against the instruction giver; the donor of the gift.

debtor substituted against his will; hence his acceptance is absolutely necessary.<sup>161</sup> Yet, in the absence of explicit terms, the creditor's acceptance may be construed to generate either the absolute or conditional discharge of the debtor. An absolute discharge completely releases the debtor from any liability to the creditor. Upon the default of the paymaster, recourse is available to the creditor only against the paymaster. Conversely, conditional discharge releases the debtor towards the creditor only as long the paymaster has not defaulted. Upon the default of the paymaster, recourse is available to the creditor against the debtor.<sup>162</sup> In effect, conditional discharge suspends the debtor's obligation until either default or actual payment made by the paymaster.

The fourth controversy, then, is whether the silence of the creditor, the beneficiary of the declaration, or even his express acceptance unaccompanied by an elaboration as to its terms, in the presence of all three, is to be interpreted as an acceptance of the paymaster's debt in absolute discharge, or merely as a conditional discharge, of the debt owed to him by the debtor. In the case of an absolute discharge, upon the paymaster's default, the only recourse available to the creditor, as beneficiary of the instruction to pay, is against the paymaster. At the same time, in the case of a conditional discharge, upon the paymaster's default, the condition has been broken, so that recourse becomes available to the creditor against the debtor, who issued the instruction to the paymaster.

**To conclude this section**, an instruction given by a debtor to a paymaster to pay the debtor's creditor is binding on both the debtor and the paymaster, and inures to the benefit of the creditor. This is so as long as the paymaster owes money to the debtor who gave the instruction, and all three parties are face-to-face at the time the instruction is given. This principle is known as the presence-of-all-three declaration.

For the instruction to be irrevocable on the debtor, binding on the paymaster, and inuring to the benefit of the creditor, all prerequisites must be met. First, the instruction must be given by the debtor in the presence of all three (meaning the presence of the two others); second, money ought to be owed by the paymaster to the debtor; third, the creditor must have consented. It is, however, not universally agreed as to whether such consent need be explicit or whether it could be implied from the creditor's lack of response to the debtor's instruction directed to the paymaster in the creditor's own presence. It also remains unclear as to whether the creditor's consent, once established, and unless its terms are explicit, is to be construed as conferring on the debtor an absolute discharge, irrespective of the default by the paymaster, or whether it confers on the debtor merely conditional discharge, pending default by the paymaster.

Other remaining controversies are whether acceptance by or consent of the paymaster is also required, whether the principle operates as a transfer of right

<sup>161</sup> See Talmud, *Bava Metzia* at 12A: 'We may not disadvantage a man except in his presence.'

<sup>162</sup> Though it may well be that recourse is available to the beneficiary against the instruction giver only after exhausting his remedies against the paymaster. Shulchan Aruch, *Chosen Mishpat*, Section 126, Rule 9.

or novation, and whether the debtor retains his power to renounce the debt owed by the paymaster. It is also not completely settled whether revocability remains possible where all prerequisites have been met, as long as the three parties remain in the presence of each other.

#### 4. REMITTING COINS TO A DISTANT PLACE: THE *DYOKANI* TRANSFORMED

As discussed in section 2 above, the Talmud has not facilitated the transfer of money owed on an oral loan. Among methods available for the transfer of money owed on deposit, *zechi* requires a voluntary act and hence co-operation by the custodian. Both *zechi* and *oditta* require some formality; *zechi* in the form of a proprietary act and *oditta* in the form of a witnessed document. *Oditta* is anyway disfavoured. For its part, the transfer by dint of land is cumbersome and inappropriate for transactions in the marketplace. As well, the issue by the debtor of an *urcheta* authorizing his creditor to collect from the debtor's debtor is inadequate to transfer to the creditor the proceeds so collected in satisfaction of the debt owed by the debtor to the creditor, no matter what language is used in the *urcheta*. Finally, payment to the creditor's agent may have discharged the debtor, though only where the agent is duly authorized by the creditor to give the discharge; however, there has been a controversy as to what fulfils authorization requirements, namely, as to whether a *dyokani* and/or *urcheta* are required. As further discussed in section 3 above, to benefit a creditor, an instruction by the debtor authorizing his own debtor to pay the creditor, whether or not followed by the agreement of the debtor's debtor, requires the presence of all three.

In the Gaonic period, which followed the conclusion of the Talmud,<sup>163</sup> the sages were confronted with need to provide a legal framework that would facilitate payment from a debtor located in one place to a creditor located elsewhere while bypassing the risk of transportation of money. They dealt with the issue against the background of the *suftaj*, a mechanism used in the Islamic Empire to make payment between distant parties.<sup>164</sup>

As fully discussed in chapter six above, the *suftaj* was one of several payment instruments that facilitated non-cash payments in the Near East during the early Middle Ages. In Islamic law and practice, the *suftaj* has been 'a loan of

<sup>163</sup> The *Geonim*, or 'excellencies', were post-Talmudic sages and scholarly leaders, first in Babylonia and then beyond, in a period that extended approximately from the seventh to around the middle of the thirteenth century CE, prior to the ascent of European Jewry. More information can be found online at: [www.britannica.com/eb/article-9036016?query=gaon&ct=](http://www.britannica.com/eb/article-9036016?query=gaon&ct=).

<sup>164</sup> See eg E Ashtor, 'Banking Instruments Between the Muslim East and the Christian West' (1972), 1 *Journal of European Economic History* 553; reprint (with same pagination) in, BZ Kedar (ed), *East-West Trade in the Medieval Mediterranean* (London: Variorum Reprints, 1986) I. See also Westreich, 'Negotiability in Talmud', above n 57 at 266–72, where a lost Jewish legal manuscript on the subject is noted (at 272). The *suftaj* is discussed in detail in ch 6, section 3 above.



money in order to avoid the risk of transport.<sup>165</sup> It is a document reflecting a borrower's undertaking to repay a monetary loan in the currency of the loan,<sup>166</sup> to a payee usually identified in the document, and who is to present it and obtain payment in a designated place other than the place of the loan.<sup>167</sup> The designated payee could either be the original lender or his nominee. A designated nominee could well be the lender's own creditor.<sup>168</sup> In the scenario on which the present discussion focuses, the debtor (in the transaction to be paid by *suftaj*) is the lender (to whom the *suftaj* is issued), the paymaster (*suftaj* issuer) is the borrower, and the designated payee is the creditor (in the transaction to be paid by *suftaj*); the debtor 'lends' the paymaster money to be repaid by the paymaster ('borrower') to the creditor in discharge not only of the 'loan' made to the paymaster by the debtor, but also of a debt owed by the debtor to the creditor, and incurred prior to and irrespective of the *suftaj*.

The *suftaj*'s history in Islamic law is checkered. Doctrine considers it an abomination because it is founded on a loan conferring profit on the lender. Profit is in the form of 'exempt[ing] the lender from the danger of the road', that is, the avoidance of the risk, and in fact the cost, of physical transport of money from place to place,<sup>169</sup> in violation of the Koranic prohibition against 'acquiring profit upon a loan.'<sup>170</sup> However, among the four principal Islamic legal traditions which make the Hanafi, Maliki, Shafi'i, and Hanbali schools of law,<sup>171</sup> response to the *suftaj* varies. Thus, the *suftaj* is only disapproved of,

<sup>165</sup> See eg J Schacht, *An Introduction to Islamic Law* (Oxford: Clarendon Press, 1964, reprint 1998) at 149.

<sup>166</sup> I suppose that the identity between the currency of the loan and the currency of its repayment was a matter of practice rather than a requirement derived from any legal doctrine.

<sup>167</sup> For the rich documentation see eg SK Bakhsh and DS Margoliouth, *The Renaissance of Islam* (trans from the German of Adam Mez) (Patna: Jubilee, 1937) at 476–77; and Ashtor, above n 164. For summary and sources see eg ND Ray, 'The Medieval Islamic System of Credit and Banking: Legal and Historical Considerations' (1997), 12 *Arab Law Quarterly* 43 at 66–79.

<sup>168</sup> But not exclusively: they could also be used by a traveller who wanted to avoid the risk of carrying money as well as for the purpose of payments to government and donations to pious foundations (such as for gifts to the poor).

<sup>169</sup> In this context, however, attention has not been paid to the commission or fee paid out by the debtor to the paymaster for the issue of the *suftaj* and hence, arguably, to cover the cost of the physical transport from place to place.

<sup>170</sup> C Hamilton, *The Hedaya or Guide: Commentary on the Mussulman Laws*, trans by order of the Governor-General and Council of Bengal, 2nd edn (with preface and index by SG Grady) (Lahore: New Book House, 1957) at 333–34. 'The Hedya or "guide" . . . consists of extracts from the most approved works of the early writers of Mohammodan Law, and was composed in the later half of the 12th century.' See *Louka v Nichola* (1901) 5 Cypr. L.R. 82 at 86, quoted by CA Hooper, *The Civil Law of Palestine and Trans-Jordan* (Jerusalem: Azriel Press, 1936) vol II at 24.

<sup>171</sup> These schools are discussed by Schacht, above n 149 at 56–68. See also NJ Coulson, *A History of Islamic Law* (Edinburgh: Edinburgh University Press, 1964) at 86–102. For a succinct account, see Hooper, *ibid* at 14–16. All such schools originated mostly in the course of the second century of Islam. Among them, the Hanafi school has been prominent in the east, particularly in Iraq and Syria, while the Maliki school has been prominent in the west, particularly in Egypt and North Africa. See Schacht, *ibid* at 65. The two original schools were the Hanafi and Maliki; the founder of the Shafi'i school was a pupil of the founder of the Maliki school, while the founder of the Hanbali school was a pupil of the founder of the Shafi'i school. The Maliki school makes heavy use of the prophetic *hadiths* (sayings of the Prophet). The Shafi'i school purports to be a synthesis of the

though not forbidden, under the Hanafi law, at least as long as the paymaster-borrower's undertaking is either voluntary or perhaps implicit. All the other three schools appear to forbid the *suftaj*; however, under Maliki law, the *suftaj* may still be permitted in case of 'necessity', which may be stretched to cover general danger in transit. For their part, Shafi'i rules have come to allow the use of the *suftaj* where it is in conformity with local usage.<sup>172</sup>

According to all Islamic schools, it is the *hawale* which explains the creditor's right to be paid by the party liable to pay on the *suftaj*.<sup>173</sup> *Hawale* literally means 'removal'<sup>174</sup> or 'turn'. It denotes the transference of an obligation from one person to another, constituted by 'an agreement by which a debtor is freed from a debt by another becoming responsible for it.'<sup>175</sup> It typically releases the original debtor altogether, so that no recourse is available against him if the one who replaces him reneges. What is transferred from the debtor to another person is an obligation to pay the debt; the *hawale* is thus distinguishable from the cession or assignment of a debt, which is the transfer from the creditor to another person of the right to the money owed or payment due on a debt.<sup>176</sup>

In our setting, the *hawale* is an agreement under which the debtor is replaced by the paymaster as the party owing to the creditor. Thus, under a *suftaj*, the creditor's right towards the paymaster is premised on a *hawale* under which the paymaster replaces the original debtor as the party owing to the creditor. Similarly, the creditor's right against the paymaster's correspondent under a *suftaj* derives from a subsequent *hawale*, under which the correspondent replaces the paymaster as the party owing to the creditor. In our setting, the paymaster is located in the debtor's place while the correspondent's location is that of the creditor. Hence, the objective of the *suftaj* is to fasten on the paymaster's correspondent a direct obligation running in favour of the creditor replacing the original obligation owed to the creditor by the debtor.

Hanafi and Maliki systems but with greater stress on analogy. The Hanbali school is the stricter among all schools; it rejects analogy, consensus, and judicial opinion as sources. For an overview, visit [www.fordham.edu/halsall/med/goldschmidt.html](http://www.fordham.edu/halsall/med/goldschmidt.html) and [www.shunya.net/Text/Islam/IslamicRef.htm](http://www.shunya.net/Text/Islam/IslamicRef.htm). For the origins of Islamic jurisprudence prior to the emergence of these schools, see H Motzki, *The Origins of Islamic Jurisprudence: Meccan Fiqh before the Classical Schools*, trans by MH Katz (Leiden-Boston-Köln: Brill, 2002).

<sup>172</sup> See Ashtor, above n 164 at 568–69; Ray, above n 167 at 64–65; and MD Santillana, *Code Civil et Commercial Tunisien* avant-projet discuté et adopté (Tunis: Imprimerie générale, 1899) note on Art 1964 at 689–91.

<sup>173</sup> The ensuing discussion largely draws on and develops Ray, *ibid*, particularly at 60–65. For further analysis and more sources see ch 6 above, particularly sections 2.2 and 3.2.

<sup>174</sup> This is the preferred word used by the *Hedya*, above n 170 at 330.

<sup>175</sup> For this definition see HAR Gibb and JH Kramers, *Shorter Encyclopedia of Islam* (Leiden: EJ Brill; London: Luzac, 1953) at 137, where it is further stated that the transference of the obligation 'is the angle around which this legal mechanism "turns".' The word further denotes the document by which the transference of the obligation is completed. *Ibid*. Particularly, for other meanings see also B Lewis, VL Ménage, Ch Pellat and J Schacht, *The Encyclopedia of Islam* (Leiden: EJ Brill; London: Luzac, 1971) New Edition vol III at 283–85.

<sup>176</sup> For *cessio* in Roman law, see A Berger, above n 136 at 387. For a comprehensive discussion, see in this book, ch 5, section 9 above.

Under Hanafi rules, the *hawale* is established by an agreement reached between the paymaster and the creditor; under all other Islamic schools, parties to the *hawale* agreement are the debtor and the creditor. Stated otherwise, under Hanafi rules, the paymaster's consent is required to establish his liability to the creditor; similarly, under Hanafi rules, the correspondent's consent is required to establish his own liability to the creditor. At the same time, under all other schools, the paymaster's consent is dispensed with as to his own liability, but is required to charge the correspondent, whose own consent is dispensed with.

Certainly, the practical effect of the *suftaj* is to transmit to the creditor the debt owed by the paymaster to the debtor. To confer on the creditor an entitlement towards the correspondent on the *suftaj*, non-Hanafi rules require the correspondent to have owed the paymaster. No such requirement exists according to the Hanafi school.<sup>177</sup>

In practice, according to the non-Hanafi schools, the acceptance by the creditor of the *suftaj* document, sent to him by the debtor, forms a bilateral agreement between them which charges the paymaster towards the creditor. In that *suftaj* document, the paymaster may both instruct the correspondent to pay the creditor and (even implicitly) authorize the debtor to send the document to the creditor. In such a case, the acceptance by the creditor of the *suftaj* document sent to him by the debtor may also be viewed as forming the creditor's bilateral agreement with the paymaster. Where the correspondent is indebted to the paymaster, that latter agreement thus charges the correspondent towards the creditor. Accordingly, the acceptance by the creditor of the *suftaj* document issued by the paymaster and sent to the creditor by the debtor is the basis for the creditor's entitlement both from the paymaster and, where applicable, from the paymaster's correspondent.<sup>178</sup>

During the Gaonic era, particularly between the eleventh and thirteenth centuries, Jews in the Near East regularly used, and relied on heavily, the *suftaj*, both in commerce and for making donations.<sup>179</sup> In variance with Islamic legal

<sup>177</sup> According to the Hanafi school, there is no requirement for a pre-existing debt owed by the paymaster to the debtor; being a voluntary undertaking by him, the paymaster may incur liability on a *hawale* as he wishes, whether or not he is indebted to the debtor. Conversely, all other schools envisage the paymaster's liability being incurred by means of a *hawale* irrespective of his volition; this is reasonable only as long as he has been liable in any case for the money owed, albeit to another person, namely the debtor. The *suftaj* is premised on a debt owed by the paymaster to the debtor, though not necessarily on a debt owed by the correspondent to the paymaster.

<sup>178</sup> See ch 6, sections 3.2–3.3.

<sup>179</sup> Various studies in Jewish history mention or reproduce original documents (usually translated to the language of the study, that is, either English or Hebrew) either (mostly) mentioning or constituting *suftajs* (and occasionally other payment orders). Original documents are either in Hebrew or Judeo-Arabic, referring either to *suftajs* or to the Hebrew equivalent, *dyokani* (as discussed below in this section). The ultimate source is SD Goitein, *A Mediterranean Society* vol I: Economic Foundations (Berkeley and LA: University of California Press, 1967) at 240–50. Other notable examples include: J Mann, *The Jews in Egypt and in Palestine under the Fāṭimid Caliphs* (Ktav, New York, 1970) vol I at 114, vol II at 125, 144, and 146; EJ Worman, 'Forms of Address in Genizah Letters' (1907), 19 *Jewish Quarterly Review* 721 at 727; Y Ben-Zvi, 'A Letter from a Jewish Merchant from the 11th Century' (1938), 3(NS) *Zion* 179 at 182 [in Hebrew]; J Mann, *Text and Studies in Jewish History and Literature* (Cincinnati, Ohio: Hebrew Union College Press, 1931) at 143–44;

doctrine,<sup>180</sup> Talmudic law does not view the avoidance of the risk of loss in transit as an unlawful profit violating the prohibition against lending and borrowing on interest. In fact, a condition under which a loan disbursed in one place is to be repaid in another designated place is stated to be valid,<sup>181</sup> regardless of whether such a condition is explicit or implied from the circumstances of the case.<sup>182</sup> Gain derived from the transportation of money has thus not been objectionable.<sup>183</sup>

At the same time, Talmudic legal principles have been less than forthcoming in facilitating the entitlement of the creditor against the paymaster or his correspondent on the *suftaj*. Indeed, under Talmudic law, the creditor may recover directly from the paymaster where the paymaster's obligation to the debtor is on a documentary note of indebtedness that has been properly transferred to the creditor.<sup>184</sup> Nevertheless, a creditor may wish to recover from the paymaster even under circumstances where such conditions are not present. Furthermore, according to strict Talmudic legal doctrine, even the proper transfer to the creditor of a documentary note of indebtedness properly executed by the paymaster does not confer on the creditor an entitlement towards the paymaster's correspondent who, as a rule, has not signed on the documentary note and is thus not liable thereon.

Arguably, to facilitate recovery of a debt owed to a creditor by a debtor located in another city, Talmudic sages could have invoked Rabbi Nathan's lien.<sup>185</sup> They could thus have allowed the creditor to collect from a paymaster located in the creditor's city where that paymaster is indebted to the out-of-city debtor. Indeed, such circumstances may have warranted the use of Rabbi

M Gill, *Palestine During the First Muslim Period (634–1099)* (Tel-Aviv: Tel Aviv University, 1983) Part I: Studies at 210, 497, Part II: Cairo Geniza Documents at 134, 150, and 633, Part III: Cairo Geniza Documents and Indexes at 112, 118, 204, and 294 [in Hebrew]; and M Gill, *In the Kingdom of Ishmael* (Tel Aviv: Tel Aviv University, 1997) vol I: Studies in Jewish History in Islamic Lands in the Early Middle Ages at 497, 555, and 635–41, vol II: Geniza Documents Concerning Babylonia and Persia at 807, vol III: Geniza Merchants' Documents at 813, 814, vol IV: Geniza Merchants' Documents at 1, 479 [in Hebrew].

<sup>180</sup> See text at nn 169–70 above.

<sup>181</sup> See Talmud, *Bava Kamma* at 118A (Mishna).

<sup>182</sup> *Ibid* (Gemara).

<sup>183</sup> Cf Talmud, *Bava Metzia* at 65A in which an account is given about agents of Bar Chama who transported his goods from a point of origin to a point of a destination for sale at a price higher than the one existing at the point of origin. Once the agents sold the goods, they treated (per their agreement with Bar Chama) the proceeds as a loan to them (given at the point of destination) to be used in their own business and ultimately repaid to Bar Chama at the point of origin. Sages would have seen the service of transporting the goods from point of origin to point of destination as forbidden interest (except that the agents were separately rewarded for it), and yet, there seems to be no concern at all by the sages as to whether the service of carrying the money from the point of destination (where loan was given) to the point of origin (where it was repaid) constituted a form of prohibited interest.

<sup>184</sup> See text that follows n 60 above.

<sup>185</sup> Thereunder, one who lent to a borrower may collect directly from a debtor of that borrower. See Talmud, *Kiddushin* at 15A; *Bava Kamma* at 40b; *Pesachim* at 31A; *Gitin* at 37A; and *Ketubot* at 19A and 82A. The rule is said to be derived from Scriptures, Numbers 5:7, according to which '[he shall] give it to the one to whom he is guilty'.

Nathan's lien.<sup>186</sup> Yet, as indicated,<sup>187</sup> Rabbi Nathan's lien underlies a method of collection of the debt owed by the debtor to the creditor, and is enforceable by court order. It is not a voluntary disposition amounting to the transfer of the debtor's debt (owed to the paymaster) into the creditor's hands, resulting from the debtor's instruction.<sup>188</sup> Thus, in trying to devise a legal theory facilitating the entitlement of the creditor against the paymaster, the sages bypassed altogether any reference to Rabbi Nathan's lien.

A pertinent discussion addressing the rights of a creditor to whom a *suftaj* is payable is that of the Gaonic Response No 423,<sup>189</sup> that can freely be translated in full as follows:

Reuven wrote to Shimon a *suftaj* from one place to another and Shimon delivered it to Levy who received from him and after that denied. And the one who delivered and he [the second receiver] admits that he did not give. May Shimon go back to Reuven and claim the *suftaj* money since he got nothing from Levy? . . . We have seen that there is nothing in the roots of our laws to permit [to send] the *suftaj*. This is so since our Rabbis said that you may not remit coins by means of a *dyokani* even when signed by witnesses. Nevertheless, having seen that people actually use the *suftaj* we recognized it so as not to hinder commerce. And we accepted upon ourselves to admit the *suftaj* under the law of the merchants and neither add nor subtract. And so is the law and it ought not to be changed.

The text deals with a situation in which Reuven and Shimon are located in different places. According to one possible understanding of the text, Reuven is the debtor, Shimon is the creditor, and Levy is the paymaster who is located in both places. Alternatively, Reuven could be the paymaster entrusted with the money by an anonymous debtor of Shimon, in which case Shimon remains the creditor while Levy is the paymaster's correspondent in Shimon's place.<sup>190</sup> Either way, Shimon presented the document to Levy who agreed to pay and then reneged. The question discussed by the Gaonic sages is whether Shimon may go back and have recourse against Reuven.

Since at some point consent of all parties was given towards Shimon, all schools of Islamic jurisprudence would hold Levy liable and Reuven released.

<sup>186</sup> Particularly, see *Shulchan Aruch* Choshen Mishpat Section 86, Rule 2, speaking of the application of Rabbi Nathan's lien to the case of a debtor who has no assets in the city or country of the creditor other than money owed to the debtor.

<sup>187</sup> See text at nn 54–57 above.

<sup>188</sup> See summary and sources in Albeck, *The Law of Property*, above n 49 at 579.

<sup>189</sup> AA Harkavy (ed), *Gaonic Responsa* (NY: Menora, 1959). Response is recorded in the original Judeo-Arabic and Hebrew translation (at 316). For background information, including attribution and context, see G Libson, *Jewish and Islamic Law: A Comparative Study of Custom During Geonic Period* (Cambridge, Mass: Harvard University Press, 2003) at 96–97, fnn 26–33. For partial similar translation and attribution, see also SD Goitein, 'The Interplay of Jewish and Islamic Laws' in R Link-Salinger (Hyman), *Jewish Law in Our Time* (Denver: Tarbut, 1982) at 55, 65–66. And in a context, see also WJ Fischel, *Jews in the Economic and Political Life of Medieval Islam* (London: Royal Asiatic Society for Great Britain and Ireland, 1937) at 17–21, particularly 19.

<sup>190</sup> For the practice of drawing *suftajs* out of money deposits held for safekeeping, see Gaonic Response No 552, in Harkavy, *ibid* at 340–41.

And yet under the Talmud, this result could not be achieved, as long as all three parties were not present together, unless Levy was obligated to Reuven on a documentary note of indebtedness that was properly transferred to Shimon; in that case, no consent by Levy would have been required in the first place, to both make him liable, and release Reuven, towards Shimon.<sup>191</sup>

Interestingly, in their efforts to confer on Shimon a right against Levy so as to discharge Reuven, the sages did not address the options of *zech*i and *oditta*. It is not all that obvious, however, whether this omission can be attributed to the treatment of the money to be transferred from Reuven to Shimon as lent rather than deposited, or whether it should be attributed to the general low esteem in which these mechanisms were held.<sup>192</sup>

Focusing on Reuven's authorization issued to his creditor Shimon to collect from Reuven's debtor, Levy, Response No 423 appears to deal with what is very much an *urcheta* setting, discussed in section 2.3 above; and yet the Gaonic sages did not address the issue of whether Reuven's letter was an *urcheta*; in fact, no direct *urcheta* issue arose. No payment was made by Levy to Shimon, so that the question of whether Shimon acquired ownership in the proceeds did not come up.

Indeed, it is precisely this lack of actual payment made by Levy to Shimon that precludes the scenario not only from being one involving an *urcheta* issue, but also from being viewed as one in which Reuven, as a creditor of Levy rather than in his capacity as a debtor to Shimon, appoints Shimon, Reuven's own creditor, as an agent to collect from Levy in discharge of both debts owed by Levy to Reuven and Reuven to Shimon. Under this (rejected) view of the matter, it is the creditor, Reuven, who appoints Shimon as an agent for collection; this would be consistent with the usual communication flow in the *dyokani* scenario as set out in section 2.4 above. However, under this (rejected) view, it is impossible to see how the debtor-Levy's engagement to pay Shimon can be seen as the equivalent of an actual payment by Levy to Shimon, carrying with it a double discharge; one from Levy towards Reuven, and the other from Shimon to Reuven.

Rather, the sages treated the case as one involving Reuven paying to Levy, with the view of achieving a discharge from Shimon; this is indeed a *dyokani* setting, except that nowhere does the text indicate that Levy was Shimon's agent. It is thus surprising that, instead of highlighting this aspect in pointing out the law from which they purported to depart, the Gaonic sages cited the ineffectiveness of payment to an agent appointed by the creditor in a letter containing a *dyokani* as grounds for the retention of recourse by Shimon against Reuven under Talmudic law. This, however, overlooks the controversy as to the

<sup>191</sup> See text that follows n 60 above.

<sup>192</sup> For these two disfavoured mechanisms, see text around nn 43–47 above. For the question of their lack of mention, see however text around nn 169–70 above. For the distinction between money lent and money deposited, see section 2.1 above.

ineffectiveness of the *dyokani*.<sup>193</sup> The Gemara discussion on the point is inconclusive and there was nothing in it to preclude the Gaonic sages from following Rabbi Yochanan as (subsequently to the Gaonic sages) was understood by Tosafot, thereby adhering to the most lenient requirements as to the appointment for an agent with a power to give a discharge by the mere issue of a *dyokani* letter. Certainly, had they still wished to adhere to the strict letter of the law, it would have been easier for the Gaonic sages to simply state that, for Levy to be an agent with the power to discharge Reuven, he must have been appointed by the creditor, Shimon, as Shimon's agent. Instead, the sages discuss a letter issued by Reuven, the debtor, to Shimon, which is contrary to the usual flow emerging from the discussion in section 2.4 above, where it is envisaged that a letter containing a *dyokani* and the designation of the paymaster as an agent for the creditor must emanate from the creditor.

Effectively, Response No 423 transforms the *dyokani* to correspond to the Islamic *suftaj* as effectuated under Hanafi rules, that is, with the consent of the paymaster and his correspondent.<sup>194</sup> Transformation occurred in two directions. First, the *dyokani* in Response No 423 is not contained in a letter issued by the creditor addressed to his debtor, authorizing him to pay to his agent. Rather, in the scenario dealt by the Gaonic sages, the *dyokani* becomes a letter issued by the debtor addressed to his creditor, authorizing him to obtain payment from a paymaster or his correspondent as instructed by the debtor. Second, if the paymaster Levy is to be treated as the creditor, Shimon's agent, this is on the basis of a retroactive appointment, occurring upon Shimon and Levy's agreement.<sup>195</sup> At the same time, it is only title to money owed on deposit and not on loan that can be so conferred on Shimon;<sup>196</sup> thus, by adhering to this perspective of acquisition by means of a retroactive appointment, the sages must be understood as confirming the delivery of money to the *suftaj* issuer as a deposit and not a loan, as in the Talmudic *dyokani* transaction<sup>197</sup> but in variance with Islamic law.<sup>198</sup> However, as a matter of fact, inasmuch as the creditor is unlikely to receive the same coins deposited by the debtor, this perspective on the post-Talmudic *dyokani* carrying out a *suftaj* transaction is flawed. Furthermore, as a matter of Talmudic legal doctrine, and taking into account its extensive 'side effects' as discussed below, this approach begs the question as to why the sages bypassed the simpler, if discredited, options of *zechi* and *oditta*.<sup>199</sup>

<sup>193</sup> See discussion above in section 2.4.

<sup>194</sup> See the three paragraphs that follow n 176 (until n 177) above.

<sup>195</sup> For acquiring property through the ratification of an acquisition made for the acquirer by a third party, thereby retroactively appointing him as an agent for the acquirer, see Ettinger above n 92 at 109–34.

<sup>196</sup> This is due to the general rule, discussed in section 2.2 above, under which only money owed on deposit and not on loan can be transferred.

<sup>197</sup> See discussion in section 2.4 above.

<sup>198</sup> See text at n 165 and text that follows it, above.

<sup>199</sup> Discussed in section 2.2 above. Certainly, inasmuch as the post-Talmudic *dyokani* is premised on a deposit and not a loan, the explanation in text at n 193 above, as to the sages' possible treatment of the transaction as a loan, falls short.



Thus, in the course of the transformation of the *dyokani*, other fundamentals were shattered. Whereas Response No 423 does not deal with the *urcheta*, the law that governs it was effectively bypassed; while per discussion in section 2.3 above, an *urcheta* would have been incapable of transferring to Shimon proceeds actually collected from Levy, Response No 423 transferred to him the claim to such proceeds even prior to their collection. As well, unlike the case set out in section 3 above, and in a situation that otherwise may have varied only slightly with that case,<sup>200</sup> Response No 423 facilitates the conferment on the creditor of a right to the money owed by the paymaster to the debtor, without all three being present. Thus, in citing a mercantile usage or custom as the basis for ‘elevating’ Shimon’s acceptance of Levy’s engagement into what is in effect a retroactive appointment by Shimon of Levy as his agent, the Gaonic sages effectively liberated themselves from the limitations of the *urcheta* as well as from the presence-of-all-three requirements. What is then startling is the lack of discussion on these points and the ease with which the Gaonic sages sidestepped them in order to accommodate mercantile practice.<sup>201</sup>

In any event, historically, the Gaonic ruling in Response No 423 remained limited to the particular machinery for transmitting payment from place to place in the context of the specific era in which it was used. As the discussion in other sections of this chapter demonstrates, Gaonic Response No 423 did not have any impact on the development of underlying principles governing the order to pay in the Talmud. In the final analysis, in transforming the *dyokani*, Response No 423 is nevertheless more a case of an ad hoc adaptation of Talmudic law rather than a prelude for a deeper transformation.

## 5. CONCLUSION: THE TALMUDIC CONTRIBUTION

So far as general principles are concerned, modern law does not inhibit the power of an agent acting with authority to give a discharge, sue, or otherwise enforce the payment of a debt on behalf of his principal.<sup>202</sup> Nor does modern law inhibit the power of a principal to confer title to an agent to money collected by his agent on a debt owed by the debtor to the principal.<sup>203</sup> Finally, in

<sup>200</sup> Eg, Response No 423 appears to require a specific agreement by the paymaster, a point which constituted the first controversy in the case dealt with in section 3 above.

<sup>201</sup> I thus join Westreich, ‘Negotiability in Talmud’ above n 57 at 271, who in dealing with this Response found the ‘unknown [to] exceed . . . the known’ and admitted to ‘have not unraveled the knot.’

<sup>202</sup> The broad principle is that ‘[a]n agent may execute a deed, or do any other act on behalf of the principal, which the principal might himself execute, make or do’. See eg FMB Reynolds, *Bowstead and Reynolds on Agency*, 18th edn (London: Sweet & Maxwell, 2006) at 44.

<sup>203</sup> In fact, the general rule at common law is that money paid by the principal’s debtor to the principal’s agent, unless segregated, becomes the agent’s money. This is so even in the absence of a debt owed by the principal to the agent, in which case the agent receiving payment from the principal’s debtor becomes a mere debtor to the principal. See *Higgs v Holiday* (1599), Cro Eliz 746, 78 ER 978 (rvs’g *Holiday v Hicks* (1598) Cro Eliz 661, 78 ER 900); for facts see *Holiday v Hicks* (1597)

modern law, money deposited with a banker is money lent to the banker;<sup>204</sup> hence, no distinction is to be made between money owed on a bank deposit or on a loan. Furthermore, debt for money owed is transferable.<sup>205</sup> These are major departures from Talmudic law.

Apart from the law of cheques, discussed in chapter four above, the specific contribution of the Talmud to the modern law governing the payment order is threefold. First, adapted to function as a *suftaj* (as discussed in section 4 above), as well as in explicitly purporting to accommodate the smooth flow of commerce, the *dyokani* letter discussed in section 2.4 bears close resemblance to the later-day bill of exchange.<sup>206</sup> Second, as discussed in section 2.2 above, the Talmud appears to be pioneering in providing for a legal framework for the transfer of a documentary note of indebtedness and, hence, in heralding the latterday negotiable instrument. Third, the availability to a creditor of recourse against the original debtor upon the default of a paymaster, namely, the conditional payment principle, is an idea to be associated with the Tur's interpretation of Baal Ha-Itur's analysis of a text from the Jerusalem Talmud, as discussed in section 3, in connection with the presence-of-all-three declaration.

Thus, forerunners of the bill of exchange, the negotiable instrument, and the conditional payment principle are all traced to the Talmud. So far as methodology is concerned, it is the rigorous discussion of general principles which may have inspired other legal systems to 'catch up' in the future as to the 'products' of this methodology. It is however the same rigorous discussion and ultimately, the courageous (albeit, in my view, poorly reasoned) departure from principle which characterizes the Talmudic quest and contribution towards the provision of its own legal framework governing the payment order. In the final analysis, it is not only the adherence to existing legal principle, but also the interaction with practical needs of commerce and a contemporary legal system (that of Islam, discussed in chapter six above) that facilitated internal progress and external impact.

*Note:* For Glossary of Post-Talmudic Jewish Law sources, see Appendix to chapter four.

Cro Eliz 638, 78 ER 878); *Whitecomb v Jacob* (1711) 1 Salk 160, 91 ER 149; and *Scott v Surman* (1742) Willes 400 at 403–04, 125 ER 1235 at 1237–38 (rationalizing the result by stating that 'as money has no earmark it cannot be distinguished'). For discussion, see: B Geva, 'Authority of Sale and Privy of Contract: The Proprietary Basis of the Right to the Proceeds of Sale at Common Law' (1979), 25 *McGill Law Journal* 32 at 53–60.

<sup>204</sup> *Foley v Hill* (1848) 2 HLC 28, 9 ER 1002 (HL).

<sup>205</sup> A statutory assignment was introduced in England by s 25(6) of the *Supreme Court of Judicature Act, 1873* (UK), 36 & 37 Vict., c. 66; yet the transferability of choses in action had been recognized in equity earlier. See account of Blackburn J in *Crouch v The Credit Foncier of England* (1873) L.R. 8 (Q.B.) 374 at 380.

<sup>206</sup> A proponent of the early bill of exchange as a mechanism for payment between distant parties is W Holdsworth, *A History of English Law*, 2nd edn (London: Methuen & Co, Sweet and Maxwell, 1937, reprinted 1966) vol VIII at 128–46.

# Payment Orders in Medieval Continental Europe: Book Transfers and Bills of Exchange

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|--------------------------------------------------------------------------------------------|-----|
| 1. Introduction: Bankers, Banking and Payments in Medieval Continental Europe              | 352 |
| 2. Deposit and Transfer Banking in Medieval Continental Europe                             | 357 |
| 3. Heraldng the Bill of Exchange: The Medieval Continental Bill of Payment                 | 369 |
| 4. The Bill of Payment: Legal Relationships                                                | 387 |
| 5. Negotiability Acquired: The Continental Bill of Exchange in the Early Post-Medieval Era | 401 |
| 6. Conclusion: Medieval Continental Contribution Assessed                                  | 418 |

## 1. INTRODUCTION: BANKERS, BANKING AND PAYMENTS IN MEDIEVAL CONTINENTAL EUROPE

THE FALL OF Rome in 476 CE marks the end of Antiquity and the beginning of the Middle Ages. For Western Europe, the end of the Middle Ages is marked by the discovery of the New World in 1492, or perhaps slightly later, in the early sixteenth century, by the division of Western Christianity in the Reformation, the rise of humanism in the Italian Renaissance, and the beginnings of European overseas expansion.<sup>1</sup> Certainly, both the beginning and the end of the period were gradual; hence, these dates are mere approximations. Moreover, in Continental Europe,<sup>2</sup> the institutional design outlined in this chapter evolved into the seventeenth century, and in fact persisted to the end of the eighteenth century. A plausible new beginning, and thus outside the scope of this chapter, is the emergence of the goldsmith bank system in England in the course of the seventeenth century. As will be seen in chapter ten below, that system gave birth to modern

<sup>1</sup> These propositions are common knowledge. See in general, eg [www.simple.wikipedia.org/wiki/Middle\\_Ages](http://www.simple.wikipedia.org/wiki/Middle_Ages) and [www.en.wikipedia.org/wiki/Middle\\_Ages](http://www.en.wikipedia.org/wiki/Middle_Ages).

<sup>2</sup> Strictly speaking, 'Western Europe' and 'Continental Europe' are not of identical geographical coverage, as only the former and not the latter includes the British Isles. This chapter focuses on developments not particular to the British Isles. Unless indicated otherwise, the chapter uses 'Western Europe' and 'Continental Europe' interchangeably. See text that immediately follows.

banking, and thus heralded the emergence of the modern payment system. Other specific aspects relating to the Common Law of England, including the origins and early evolution of English law governing the bill of exchange, are outwith the scope of this chapter and are dealt with in chapter nine below. Otherwise, to the extent that it became involved in international trade in the late Middle Ages, England is covered in the present discussion. Hence, the title of the chapter, specifically referring to 'Continental Europe', is not designed to exclude England, but rather, to stress the geographical location of the principal activity for matters discussed in the chapter. This is in order to contrast the subject of the present chapter with the more 'local' or, more precisely, English-based themes of the three following chapters (chapters nine, ten and eleven). As for the timeframe covered by this chapter, for our purposes, 'Medieval' then denotes a period that continued long after the Middle Ages, so as to last until what can generally be seen as the beginning of the modern era.

It does not follow that throughout the entire Middle Ages the picture was static; furthermore, as set out particularly in section 5 below, specific stages in the development clearly took place after the Middle Ages proper. At the same time, such stages, inasmuch as they may have signalled the dawn of a new beginning, were steps in the evolution of concepts and institutions that had emerged in the Medieval era proper, and are treated in this chapter from that perspective. This chapter thus deals with developments pertaining to the payment order, and the law applicable to it, that occurred in Continental Europe during the era that commences around the fall of Rome and ends at the eighteenth century.<sup>3</sup>

In the early centuries of the Middle Ages, the economy collapsed and trade was reduced to a trickle. Monetary economy survived only in a rudimentary form and banking and non-cash monetary payment systems ceased to exist altogether.<sup>4</sup> Indeed, the last Roman banks disappeared in the course of the sixth and seventh centuries. At the same time, possibly banks, and certainly non-cash monetary payments, continued to exist in the East, both in Byzantine Constantinople and, as extensively discussed in chapter six, throughout the Islamic lands. Contact between East and West did not cease to exist between the sixth or seventh and the twelfth centuries. Furthermore, knowledge of the past had not been completely eradicated. And yet the newly reborn Medieval banking system in Western Europe had its own features.

<sup>3</sup> In general, I follow the outline of R De Roover, 'New Interpretations of the History of Banking' in J Kirshner (ed), *Business, Banking, and Economic Thought in Late Medieval and Early Modern Europe: Selected Studies of Raymond De Roover* (Chicago and London: University of Chicago Press, 1974, Phoenix Edition, 1976) at 200 (hereafter: De Roover, 'New Interpretations') where he covers Continental and British developments until the early nineteenth century.

<sup>4</sup> RS Lopez, 'The Dawn of Medieval Banking' in Center for Medieval and Renaissance Studies, University of California, Los Angeles (ed), *The Dawn of Modern Banking* (New Haven and London: Yale University Press, 1979) at 1, 3–5. For payments in kind assessed in monetary value and on occasion supplemented with low-value coins, that took place in the Carolingian Empire (eighth century CE), see eg A Murray, *Reason and Society in the Middle Ages* (Oxford: Clarendon Press, 1978, reprint 2002) at 31–35.

Not surprisingly then, the ancestry of banks and non-cash monetary payments as they reappeared in the course of the twelfth century in Italy is disputed. Particularly, it is unsettled as to whether Medieval Continental banking, including the facilitation of non-cash monetary payments, was brought about by influence from the East, or by the rediscovery of institutions and practices from Antiquity. Alternatively, it may have been the product of new creativity, effectively leading, at least to some extent, to what may be described as the 'reinvention of the wheel', namely the reintroduction of institutions and machineries that had already been known in the earlier more advanced economy but were forgotten.<sup>5</sup>

In the final analysis, however, foreign influence cannot be discounted; in some areas, particularly deposit banking, it may have played a greater role than in others. At the same time, European Continental banking had distinctive features of its own; though some such features may have been affected by developments from elsewhere, at their inception, they appear original. Such is the case particularly with regard to the bill of exchange.

Banking services reappeared in Europe in the later part of the Middle Ages to satisfy the growing demands of trade. Bogaert points to Genoa as being the first city in which moneychangers became bankers.<sup>6</sup> Lopez is more cautious; rather, he states, 'Genoa happens to preserve the earliest notarial minute books that have survived (from 1154 on) . . . [which] are the first source that contains a fairly large number of documents showing bankers at work.'<sup>7</sup> There is however no disagreement that 'banking' in Continental Europe was reborn in Italy<sup>8</sup> and 'exported' from Italy elsewhere<sup>9</sup> in the course of the twelfth and thirteenth centuries, as part of a commercial revolution that took place as of the eleventh

<sup>5</sup> R Bogaert, *Les Origines Antiques de la Banque de Dépôt* (Leyde: AW Sijthoff, 1966) at 159–73.

<sup>6</sup> *Ibid* at 167.

<sup>7</sup> Lopez, above n 4 at 10.

<sup>8</sup> For developments in Medieval Spain, see AP Usher, *The Early History of Deposit Banking in Mediterranean Europe* (Cambridge, Mass: Harvard University Press, 1943) vol I at 237–504 (covering 1240–1723 in Catalonia) (hereafter: Usher, *Deposit Banking*); and further, M Riu, 'Banking and Society in Late Medieval and Early Modern Aragon' in Center for Medieval and Renaissance Studies, University of California, Los Angeles (ed), *The Dawn of Modern Banking* (New Haven and London: Yale University Press, 1979) at 131. Particularly for extensive documentation, see also: AE Sayous, 'Les Méthodes Commerciales de Barcelone au XIVe Siècle, Surtout d'Après des Protocoles Inédits de ses Archives Notariales' (1933), 18 *Estudis Universitaris Catalans* 209, particularly at 217–23 (as well as 231 and 233–34); and AE Sayous, 'Les Méthodes Commerciales de Barcelone au XVe Siècle, d'Après des Documents Inédits de ses Archives' (1936), 15 (Ser 4) *Revue Historique de Droit Français et Étranger* 255 at 274–86 (hereafter: Sayous, *Méthodes Commerciales XV*). For a broader earlier Christian (namely West European)-Mediterranean perspective, see AE Sayous, 'L'Histoire Universelle du Droit Commercial de Levin Goldschmidt et les Méthodes Commerciales des Pays Chrétiens de la Méditerranée aux XIIe et XIIIe Siècles', Pt II (1931), *Annales de Droit Commercial Français, Étranger et International* 309 at 310–12, 317–20 (hereafter: Sayous, 'Méthodes Commerciales XII et XIII').

<sup>9</sup> See eg AE Sayous, 'Les Opérations des Banquiers Italiens en Italie et aux Foires de Champagne Pendant le XIIIe Siècle' (1932), 170 *Revue Historique* 1 (hereafter: Sayous, 'Banquiers Italiens'); and M Prestwich, 'Italian Merchants in Late Thirteenth and Early Fourteenth Century England' in Centre for Medieval and Renaissance Studies, University of California, Los Angeles (ed), *The Dawn of Modern Banking* (New Haven and London: Yale University Press, 1979) at 77.

century or so. The revolution occurred in the aftermath of the feudal anarchy of the manorial economy of the Dark Ages.<sup>10</sup>

So far in this chapter, 'banking' has been used quite loosely, denoting financial services in general. In this sense, as will be seen below, Medieval 'banking' was not limited to financial intermediation. Thus, broadly speaking, the Medieval Continental financier fell into one of three categories.<sup>11</sup> A financier could be (i) a pawnbroker, (ii) a moneychanger who accepted deposits, or (iii) a merchant banker dealing in exchange.<sup>12</sup> Either way, in charging a fixed rate of interest on a money loan, he would be condemned by the Church as a usurer.<sup>13</sup> People took this condemnation seriously;<sup>14</sup> accordingly, pawnbrokers 'were deliberate public sinners, likened to prostitutes, and hence tolerated on earth but earmarked for hell unless they repented and made full restitution'.<sup>15</sup> Moneychangers who accepted deposits could charge a fee for their services; 'it was equally obvious that the changer's stock in trade would be largely borrowed and lent at interest rates not openly declared'.<sup>16</sup> Finally, as will be seen below in section 3, merchant bankers structured the exchange transaction so as not to be a money loan and thus exempted from the usury condemnation.

The first category, that of the pawnbrokers, consists of lenders who lent out of their capital; as such, strictly speaking, they were not bankers; they neither accepted deposits, nor provided non-cash monetary payment services.<sup>17</sup> They lent small amounts primarily for consumption, and played no role in the development of the payment system. Indeed, Medieval banking is usually associated with the second and third categories, in that order, consisting of deposit and

<sup>10</sup> For a detailed discussion on this general context, see R De Roover, 'The Organization of Trade' in MM Postan, EE Rich and E Miller (eds), *The Cambridge Economic History of Europe*, vol III: Economic Organization and Policies in the Middle Ages (London: Cambridge University Press, 1963, reprint 1979) ch II at 42 (hereafter: De Roover, 'The Organization of Trade').

<sup>11</sup> Lopez, above n 4 at 6–7.

<sup>12</sup> R De Roover, 'Banking and Credit in the Formation of Capitalism', Fifth International Conference of Economic History Leningrad 1970 (Paris, 1979) at 9 (hereafter: De Rover, 'Banking and Credit'). See in detail, R De Roover, *Money, Banking and Credit in Mediaeval Bruges: Italian Merchant Bankers, Lombards and Money Changers: A Study in the Origins of Banking* (Cambridge, Mass: The Mediaeval Academy of America, 1948; republished, London: Routledge/Thoemmes Press, 1999 as vol II of *The Emergence of International Business, 1200–1800*).

<sup>13</sup> Lopez, above n 4 at 4. For a concise historical review of the Medieval prohibition against usury, see eg JH Munro, 'The Medieval Origins of the Financial Revolution: Usury, *Rentes*, and Negotiability' (2003), 25 *International History Review* 505, particularly at 506–42 as well as 560–61.

<sup>14</sup> De Roover, 'Banking and Credit', above n 12 at 10–12.

<sup>15</sup> Lopez, above n 4 at 7. In any event, he was given the hope of salvation through purgatory. See J Le Goff, 'The Usurer and Purgatory' in Center for Medieval and Renaissance Studies, University of California, Los Angeles (ed), *The Dawn of Modern Banking* (New Haven and London: Yale University Press, 1979) at 25.

<sup>16</sup> Lopez, *ibid* at 7. In any event, 'most changers lightened their guilt by including in their will a token bequest to a charity' which they called 'restitution of any "ill-gotten" money'. *Ibid*.

<sup>17</sup> Members of this group could have been further divided into pawnshops, and retail banks, as was the case in Florence in the fifteenth century. The latter gave loans secured by jewellery, took time deposits but did not carry out book transfers. See eg R De Roover, *The Medici Bank: Its Organization, Management, Operations and Decline* (New York: New York University Press, 1948) at 1–2 (hereafter: De Roover, *Medici*).

exchange bankers, who respectively derived their roots in the manual change and long-distance exchange of money, and whose principal activities, unlike that of the first category, were outside the usury prohibitions.<sup>18</sup> At the same time, between these two categories, it was only the second category, that of deposit-transfer banking, that is associated with financial intermediation in the modern sense.

The second category is that of deposit bankers. These were moneychangers who started to obtain funds on deposit from the public. In accepting deposits they primarily borrowed funds with the view of lending or investing them. They further provided non-cash payment services facilitating transfers on their books from one account to another, and were thus sometimes called transfer bankers. Members of the public were eager to deliver funds to them for safekeeping as long as these funds were to remain available to depositors on demand. These were deposit bankers in the true sense of the word. They are thus of tremendous interest in the present study.

The third category is that of merchant bankers. Large merchants, particularly those having branch networks or correspondents throughout Europe, became involved in the transmission of money from place to place. In the fourteenth and fifteenth centuries they were predominantly Italian; in the sixteenth century, the centre of gravity shifted to Germany.<sup>19</sup> Such a merchant banker received money in one place in one currency and had it paid in another place in another currency. Merchant bankers thus combined their foreign trade with an exchange activity. The mechanism they used for the exchange gave rise to the modern bill of exchange. Having dealt with currency exchange so as to give rise to the bill of exchange, they are called exchange bankers. They settled their payment obligations in fairs in a mechanism that heralded organized interbank clearing and settlement systems in a multilateral setting. As the creators of both forerunners for the modern bill of exchange and the interbank clearinghouse, they are also of great interest in the present study.

As a matter of history, these categories have not been mutually exclusive. Particularly, some merchant bankers of the third category also acted as local deposit bankers and performed local book transfers. As well, some deposit bankers carried out limited exchange operations. At the same time, while the development of the bill of exchange is primarily linked to the operations of merchant bankers, both deposit-taking and book transfers originated in Medieval Europe in the activities of the moneychangers. Hence, while recognizing that boundaries are not absolute, the existence of more or less separate categories is meaningful.

<sup>18</sup> R De Roover, 'La Structure des Banques au Moyen Âge', Third International Conference of Economic History (Munich, 1965) vol V at 159.

<sup>19</sup> For the transition see eg: JF Bergier, 'From the Fifteenth Century in Italy to the Sixteenth Century in Germany: A New Banking Concept?' in Center for Medieval and Renaissance Studies, University of California, Los Angeles (ed), *The Dawn of Modern Banking* (New Haven and London: Yale University Press, 1979) at 105.



Generally speaking, then, in Continental Europe, moneychangers became deposit and transfer bankers as of the late part of the twelfth century. They acted as such until the first part of the sixteenth century. During that period they accepted deposits, gave loans out of them, facilitated book transfers, and sometime provided chequing services. In the course of the sixteenth century they disappeared. To a large extent, their functions were taken over by public banks, except that the latter were restricted, if not precluded altogether, from making loans and otherwise extending credit. They continued to exist until the end of the eighteenth century.

While at their inception deposit and transfer bankers dealt with bills of exchange, this function was taken over by well-capitalized large merchants, who used their extensive branch or correspondent networks to transmit funds from place to place in currency-exchange transactions. In fact, merchants dealt with bills of exchange as of the early twelfth century; over the years some of them became merchant bankers, otherwise called exchange bankers. Those businesses continued to exist until the end of the eighteenth century. As indicated, it was the activities of these bankers that gave rise to the modern bill of exchange as well as to the clearinghouse.<sup>20</sup>

The ensuing discussion in this chapter outlines the evolution of principal institutions and mechanisms. Section 2 deals with deposit and transfer banking. Sections 3 and 4 deal with the bill of payment, with section 3 covering its evolution and section 4 discussing the legal relations thereunder. Section 3 also covers the interbank settlement mechanism for bills of payment that is the forerunner of organized interbank clearing in a multilateral setting. The bill of payment is the forerunner to the negotiable bill of exchange, in a process discussed in section 5. Section 6 provides a summary of the Medieval contribution. It also assesses the extent to which Medieval banking borrowed from earlier banking and money transfer elsewhere.

## 2. DEPOSIT AND TRANSFER BANKING IN MEDIEVAL CONTINENTAL EUROPE

As indicated, institutional demarcation lines had not been firm. In fact, both distinctions and overlaps existed right from the beginning of Continental

<sup>20</sup> This is contrary to Holdsworth, who attributes the invention, use and development of the bill of exchange to moneychangers, or in his language, to 'the exchangers, whose business it was to give coins of one state in exchange for the equivalent value of coins of another state'. W Holdsworth, *A History of English Law*, 2nd edn (London: Methuen & Co, Sweet and Maxwell, 1937, reprint 1966) vol VIII at 128. 'Money change' and 'exchange' are also used interchangeably by C Verlinden, 'Markets and Fairs' in MM Postan, EE Rich and E Miller (eds), *The Cambridge Economic History of Europe*, vol. III: Economic Organization and Policies in the Middle Ages (London: Cambridge University Press, 1963, reprint 1979) ch III at 119, 136–37. For 'the great international merchant-bankers', inventors of the bills of exchange as a separate category from 'the money changers, who dealt in actual exchange of coins and the trade in bullion and precious stones', see also I Origo, *The Merchant of Prato* (Middlesex, England: Penguin in association with Jonathan Cape, first published 1957, reprint 1986) at 147.

Medieval banking. Thus, archival research reveals that moneychangers were the first bankers in Medieval Europe, and yet wealthy merchants had been the first to provide banking services. The term designating a banker, *bancherius*, is derived from *banca*, meaning 'table', which refers to the table at which the moneychanger did business. Indeed, Genoese notarial records from the twelfth and early thirteenth centuries, more specifically, between 1155 and 1216, clearly identify moneychangers as the first bankers, who made their first appearance as such late in the twelfth century.<sup>21</sup> However, the same records identify wealthy merchants as conducting, earlier in that century, isolated banking transactions as incidental activities. It is however the moneychanger that came to conduct different types of banking transactions as a principal business activity. At the same time, the banker did not have a monopoly on such transactions and services, whose provision by other businesses had not stopped with the transformation of the moneychanger to a banker.<sup>22</sup>

In connection with these Genoese notarial records, 'banking' ought to be understood as consisting of inter-city exchange, credit extension, and deposit taking. Most of the exchanges were between Genoa and the fairs. Credit operations were in the form of business loans. Deposit taking was originally in the form of 'a strong-box sort of contract obliging the custodian to return the identical objects intrusted to his care.'<sup>23</sup> However, with the advent of the commercial revolution, depositors became more and more interested in having the funds producing profit; coincidentally, the bankers came to view the deposits as capital to be invested by them for their own profit. Gradually, business arrangements began to develop between depositor and depositary-banker; originally, the banker would invest deposit funds for the mutual benefit of both himself and the depositor under a profit-sharing agreement. Subsequently, bankers commenced to give depositors a fixed rate of interest, agreed in advance, though predominantly, in order not to be in flagrant violation of usury laws, under an arrangement that nominally called for a rate of return in the banker's profits, determined at the banker's 'discretion'. Subject to paying the fixed rate of interest as effectively agreed in advance, bankers used funds on deposit exclusively for their own profit and advantage.<sup>24</sup>

Genoese notarial registers do not record non-cash payment activities.<sup>25</sup> However, it appears that such activities actually took place, except that they

<sup>21</sup> And yet parallel developments took place around the same time elsewhere in Italy. See TW Blomquist, 'The Dawn of Banking in an Italian Commune: Thirteenth Century Lucca' in Centre for Medieval and Renaissance Studies University of California, Los Angeles (ed), *The Dawn of Modern Banking* (New Haven and London: Yale University Press, 1979) at 53.

<sup>22</sup> See in detail, MW Hall, 'Early Bankers in the Genoese Notarial Records' (1935), 6 *Economic History Review* 73.

<sup>23</sup> Hall, *ibid* at 76–77.

<sup>24</sup> See De Roover, 'New Interpretations', above n 3 at 201–02 and RA Goldthwaite, 'The Medici Bank and the World of Florentine Capitalism', *Past and Present* No 114 (February 1987), 3 at 14. See also De Roover, *Medici*, above n 17 at 53, and in general, 52–59. In general for the commercial revolution of the eleventh century see n 10 and text above.

<sup>25</sup> Hall, above n 22, does not even mention them.

were not important enough to involve notary services. An important source of information as to the existence of book transfers is a set of testimonies relating to a lawsuit in Genoa in 1200, which was recorded by a notary. Witness statements make the following germane points regarding the operations of Genoese bankers:<sup>26</sup>

1. Merchants had bank accounts and used them to make payments by means of book transfers;
2. Credit was extended to depositors by means of overdrafts; and
3. Interbank arrangements existed for the facilitation of non-cash payments between accounts kept with different bankers.

To make book transfers, customers were required to appear in person at the bank. Apparently, then, payment orders were oral. The procedure for an inter-bank payment and settlement is unfortunately unclear.<sup>27</sup> Moreover, procedures and perhaps book-keeping methods may not have been completely reliable.<sup>28</sup>

In the Medieval era, deposit banking is said to be the outgrowth of manual exchange.<sup>29</sup> As originally in Ancient Greece,<sup>30</sup> it was the moneychanger who started taking deposits. By 1350, in becoming bankers,<sup>31</sup> moneychangers developed a system of local payments by book transfers, with the view of eliminating '[t]he great inconvenience of making all payments in specie, especially the waste of time involved in counting coin.'<sup>32</sup> As in twelfth-century Genoa, the system that developed was strictly local; no facility for inter-city book transfers is known to have existed throughout the Middle Ages.

Indeed, this pattern is evidenced by Venetian banking experience. Between the late thirteenth and early fourteenth centuries the moneychangers of Venice, the *campsores*, became bankers.<sup>33</sup> They accepted deposits, lent out of them, and provided payment services from and to current accounts kept with them.<sup>34</sup> According to a study on Venice banks in the fourteenth and fifteenth centuries:

<sup>26</sup> RL Reynolds, 'A Business Affair in Genoa in the Year 1200: Banking, Bookkeeping, a Broker (?), and a Lawsuit' in *Studi di Storia e Diritto in Onore di Enrico Besta* (Milan, Dott A Giuffrè 1938) II at 165, 171–72.

<sup>27</sup> De Roover, 'New Interpretations', above n 3 at 202.

<sup>28</sup> Reynolds, above n 26 at 171.

<sup>29</sup> The view that attributes an important role in the early era of banking to the lending function, expressed by Sayous, 'Banquiers Italiens', above n 9 at 2 and 6, is now out of favour. See eg Hall, above n 22 at 76 and De Roover, 'New Interpretations', *ibid* at 202.

<sup>30</sup> See ch 3, section 3 above.

<sup>31</sup> De Roover, 'New Interpretations', above n 3 at 213.

<sup>32</sup> See R De Roover, 'What is Dry Exchange?' in J Kirshner (ed), *Business, Banking, and Economic Thought in Late Medieval and Early Modern Europe: Selected Studies of Raymond de Roover* (Chicago and London: University of Chicago Press, 1974, Phoenix Edition 1976) 183 at 184 (hereafter: De Roover, 'Dry Exchange').

<sup>33</sup> Holdsworth, above n 20 at 178.

<sup>34</sup> See in detail: RC Mueller, 'The Role of Bank Money in Venice, 1300–1500' (1979), 3 *Studi Veneziani* (NS) 47. The discussion that immediately follows on the Bank of Venice is based on this article.

The convenience offered by medieval banks was conceivably as important to contemporary businessmen as are chequing accounts today. The potential depositor was likely to acquire many various currencies, foreign and local, legal and non-legal tender, good and bad. These he would bring to the banker, who would weigh and evaluate them and accept them at their intrinsic or market value calculated in money of account. The money of account, in turn, was the expression of the legal tender standard maintained by the government mint. The money-changer/banker, perhaps after deducting an exchange fee or commission, gave the depositor credit on his books by opening an account in his name. The demand deposit is a liability on the banker's balance sheet and is the client's claim on the specie he deposited. His transferable asset now merely 'consists of figures in bank ledgers and is money only because of confidence in the ability of the banks to honor their liabilities when called upon to do so'. It becomes a kind of fiduciary money, a claim for which the banker has substituted his 'promise to pay' for that of the depositor in the making of payments.<sup>35</sup>

That system was premised on the fact that customers deposited money also for convenience or safekeeping; that is, the system involved deposits not made for investment or otherwise as a source of income. Rather, customers held current accounts, in which deposits were made, to be used for book transfers. Parties to a book transfer had to appear in person before the bankers; that is, only oral payment orders were accepted. Written orders, as distinguished from letters authorizing agents to act on behalf of parties, did not exist. The inscription by a banker of a debit and credit in a current account was authoritative as a notarial instrument, and hence reliable. The personal-presence requirement did not involve any inconvenience since banks and merchants were all located close to each other.

Bankers held accounts with each other which allowed for interbank transfers, though I am not sure how this was handled in terms of satisfying the requirements that both parties were to appear before the bank. Possibly, the procedure for an interbank transfer also required each banker to appear before the other. One may speculate that first, the two parties appeared together with the payee's banker at the payer's banker, and subsequently, the two parties appeared together with the payer's banker at the payee's banker. Alternatively, the presence of the bankers was dispensed with, as they relied on each other, and anyway would settle only periodically, so that it is only the parties themselves that had to attend at each banker. Either way, it looks as if the procedure required two 'attendances' at a banker's place as opposed to one only in an in-house transfer on the books of the same bank.<sup>36</sup>

Accounts among major banks may have been settled only on irregular intervals. In fact, the existence of correspondent accounts by banks with each other was often abused. Such was the case when a customer wishing to withdraw cash

<sup>35</sup> Mueller, *ibid* at 48.

<sup>36</sup> These are my own speculations as I found no indication as to the procedure in the sources available to me. At the same time, and contrary to Mueller above n 34 at 74–76, M Manning, E Nier and J Schanz (eds), *The Economics of Large-value Payments and Settlement: Theory and Policy Issues for Central Banks* (Oxford: Oxford University Press, 2009) at 24 find 'no conclusive evidence' for interbank transfers in Medieval Venice.

was sent by his banker to a correspondent (holding an account for the customer's banker) – who may have sent the customer to another correspondent (holding an account for the correspondent of the customer's banker) – and so on.

Banks kept with them only a fractional reserve, namely, a limited amount of coined money, ready to satisfy an anticipated demand for cash withdrawal; they lent or invested most money received on deposit. Availability of payment by book transfers, recognized by early fourteenth-century legislation in Venice, allowed banks to reduce cash holdings even further and increase their investments and credit extensions.

Loans were made by banks in coin, by way of an overdraft allowed to be incurred on a current account, as well as in the form of a credit entry to a current account. This required tight regulation dealing with a variety of subjects, such as banks' obligations to pay in cash on demand, the discouragement of banks to send customers seeking cash from one bank to another, and above all, licensing of banks, a procedure which included a requirement to post surety with a state magistracy before being licensed. While there were no circulating banknotes, the system as a whole expanded the monetary base, so that money actually consisted of coins in the hands of the public plus deposits kept with banks. Such deposits served as 'bank money' and were very popular in making a variety of commercial, rental, and government payments.

This local banking system was typical for Continental Europe throughout the fourteenth and fifteenth centuries. According to Huvelin, the banker's promise to the payee could be explained under Roman law as *receptum argentarii*.<sup>37</sup> As discussed in chapter five, section 5 above, the *receptum* was a banker's promise, acting under the instruction of his client and for the client accommodation, to perform on a fixed date towards a third party. Huvelin was cognizant that by the time of Justinian's reform projects in the sixth century CE the *receptum argentarii* had gone into disuse,<sup>38</sup> but claimed that this was confined to the Eastern Empire and did not reflect the reality in Italy.<sup>39</sup>

One advantage of this explanation is that, as discussed in chapter five, section 5 above, under the *receptum argentarii*, the banker's undertaking is independent, namely entirely autonomous; free of defences that may have been available to the client against the third party. At the same time, the banker's undertaking to the third party under *receptum argentarii* does not impact the client's own original obligation to the third party, so as not to be tantamount to its full discharge. This is however contrary to the prevailing understanding of the Medieval bank book-transfer mechanism as discharging altogether the payer-client's obligation. Hence, the *receptum argentarii* explanation may be unsatisfactory.

<sup>37</sup> P Huvelin, 'Travaux Recents sur l'Histoire de la Lettre de Change' (1901), 15(1) *Annales de Droit Français, Étranger et International* 1 at 20–21 text and fn 1 (hereafter: Huvelin, 'Travaux').

<sup>38</sup> A point highlighted in Justinian's Code, Book IV, Title XVIII, Paragraph 2 (translation to French by PA Tissot, as vol IX of *Corps de droit civil Romain* (Metz, 1807, reprint 1979, i Aalen, Germany, by Sceintia Verlag), at 39. See in this book, ch 5, section 8, text and n 197 above.

<sup>39</sup> Huvelin, 'Travaux', above n 37 at 20, fn 1.

An alternative analysis is provided by De Roover, who speaks of the method of payment by book transfer as an 'assignment in bank' which '[a]ccording to the medieval jurists . . . discharged the debtor from any other obligation.'<sup>40</sup> Relying particularly on a fourteenth-century Italian jurist named Bartolo Da Sassiferrato, he refers to the book transfer as an 'assignation',<sup>41</sup> requiring the consent of the debtor, banker, and creditor. Upon the occurrence in a bank of that transaction, the debtor is irrevocably discharged, so that the transfer is equal to payment in current coins. This is so 'on condition that the banker or moneychanger promises the creditor to hold the sum transferred at the creditor's disposition.' This rule effectively treats the book entry on the banker's books as an absolute discharge of the original debt, upon which the creditor forfeits his recourse against the original debtor. The rule is said to apply, however, only to a bank transfer. Otherwise, that is, in an 'assignation' on a third party other than a public moneychanger, the creditor keeps his recourse right against the debtor in case the non-bank third party declines to honour his undertaking.<sup>42</sup>

De Roover's analysis requires further discussion. Inasmuch as his reasoning appears to be premised on *cessio*, namely the transfer to the payee/creditor of the debt owed by the banker to the payer/debtor, it does not explain the autonomy of the banker's obligation, namely its enforceability by the payee-creditor against the banker free of defences that may have been available to the banker against the payer/debtor.<sup>43</sup> However, upon further reflection, De Roover's explanation does not purport to be based on *cessio*; this is so since he specifically mentions a requirement as to the consent of *all* three, namely the payer, banker, and payee, and not only that of the payer and the payee, as would have been the case under *cessio*. Thus, De Roover's reasoning is not premised on the cession or assignment to the payee of the debt owed by the banker to the payer; the banker's consent would have been dispensed with in *cessio*. Indeed, a banker is likely to agree to the transfer of a credit balance from the account of one customer to that of another, and may be in breach of contract if he declines to act on the transfer instructions; hence the banker's consent is likely to be routinely given. At the same time, his consent and affirmative response in the form of posting on his books the entries reflecting the book transfer is an essential component of the payment transaction; this precludes the book transfer from being a mere *cessio* from the payer/debtor to the payee/creditor.

<sup>40</sup> De Roover, 'New Interpretations', above n 3 at 215, 216 respectively.

<sup>41</sup> For this term see above, ch 5 at text and n 262.

<sup>42</sup> R De Roover, *L'Evolution de la Lettre de Change XIVe–XVIIIe Siècles* (Paris: Librairie Armand Colin, 1953) (hereafter: De Roover, *Lettre de Change*) at 208. See also at 212–13. In these three pages he summarizes the views of Bartolo Da Sassoferrato (1314–1357); Baldo Degli Ubaldi (1327–1400); and Giasone Del Maino (1435–1519). De Roover acknowledges (*ibid* at 208) Bartolo's text to be 'obscure' but claims to follow its usual interpretation including by the two other jurists. *Ibid* at 85–87. De Roover refers to the distinction between a book transfer with a banker and that with another debtor, a point to be revisited in section 5 below in relation to the origins of 'endorsement'.

<sup>43</sup> The general rule for *cessio* is that the transferee takes the debt subject to defences available to the obligor against the transferor. See above, ch 5, section 9.

In the final analysis, the payer's discharge upon the bank book-transfer appears to be premised on the banker's autonomous obligation towards the payee, which can be enforced by the payee free of the banker's defences against the payer. Other than the absence of required formalities under Roman law, this is certainly reminiscent of a perfect execution of a delegation order by means of novation by stipulation, discussed in chapter five, section 6 above.

The Medieval banking book transfer thus requires the presence and consent of all three parties, namely, debtor-payer, creditor-payee, and paymaster-banker. Strictly speaking then, in not being satisfied with a bilateral agreement, it could be classified neither as a delegation,<sup>44</sup> requiring the creditor-paymaster's agreement, nor an assignment-cession, requiring only the debtor-creditor agreement.<sup>45</sup> At least in a superficial way, it is reminiscent of the Talmudic presence-of-all-three declaration.<sup>46</sup>

On its part, the presence-of-all-three requirement, and hence, the lack of reliance on a written instruction, was bound to eliminate fraud. The requirement was not a source of inconvenience, because usually all three were situated in the same vicinity and the banker tended to keep his books available on his desk.<sup>47</sup> However, on occasion, the debtor was ill and thus inhibited from coming to the banker. It is on such rare occasions that written payment orders started to be used. Gradually however, already throughout the fourteenth and fifteenth centuries, written payment orders spread and became common, first in Italy, outside Venice, particularly in Tuscany, including Florence, and then elsewhere outside Italy.<sup>48</sup> Initially, '[w]ritten instruments could be used . . . only as supplementary memoranda or as instruments appointing an agent'.<sup>49</sup> When they became payment orders, whose presentment to the banker by one party dispensed with the presence of the other, their function was to generate either a cash payment or a book transfer.

Possibly some such payment orders were in effect cheques, each issued by the payer/debtor to the payee/creditor, instructing the banker to pay to the payee/creditor, as well as authorizing the payee/creditor to collect from the banker.<sup>50</sup> It is in this process that a Medieval cheque mechanism was born. However, Medieval cheques were not negotiable, usually even non-transferable;<sup>51</sup> possibly

<sup>44</sup> For the perfect execution of the delegation by means of novation by stipulation, see above, ch 5, section 6.

<sup>45</sup> For *cessio* in Roman law, see above, ch 5, section 9.

<sup>46</sup> Discussed at length above, in ch 7, section 3.

<sup>47</sup> A point highlighted by Usher, *Deposit Banking* above n 8 at 90, where he speaks of 'the custom of transacting all important business in person if possible' as facilitated by '[t]he compactness of medieval and early modern towns and the concentration of the commercial community'.

<sup>48</sup> For Barcelona, see eg Usher, *ibid* at 283–88.

<sup>49</sup> Usher, *ibid* at 283.

<sup>50</sup> For this nature of the cheque, see above ch 4 (possible Talmudic origins) as well as ch 3, section 5 (Greco-Roman Egypt).

<sup>51</sup> However, notwithstanding sources in the following note, see the in-depth discussion (in Italian) of F Melis, *Note di Storia della Banca Pisana nel Trecento* (Pisa: Società Storica Pisana, 1955) on an extensive cheque collection from the second half of the fourteenth century in Tuscany. Melis identifies cheques transferable by the instruction of the payee placed on the back (*recto*) of the cheque



other than in specific times and places they were not widely used.<sup>52</sup> They initiated either a payment in cash or a book transfer; either way the cheque accomplished 'the transfer of the creditor's right against the banker to a third party'<sup>53</sup> and thus did not generate a legal perspective of its own.

It appears that major innovations took place in Amsterdam, presumably in the transition from the sixteenth to the seventeenth century.<sup>54.1</sup> Thus, money-changers, 'transformed' to 'cashiers' (or *kassiers* in Dutch), facilitated payments initiated by 'written . . . *assignaties*'. These instruments, embodying depositors' payment orders given to their 'cashiers', 'acted as cheques' that '[l]ike bills of exchange . . . were endorsable'<sup>54</sup> and thus might pass, as means of payment, from hand to hand.' As well, the receipts 'cashiers' issued to their depositors, 'could take the form of promises to (re)pay the sum deposited'. As such, these instruments served as goldsmith notes, and 'equally became negotiable by endorsement'. Gradually, such promises became payable to bearer, and 'effectively raised the money supply'.<sup>55</sup> This reads as a forerunner of the English goldsmith system, to be discussed below in chapter ten, that heralded modern banking. However, in Amsterdam, a parallel development was arrested with the establishment of the Bank of Amsterdam (the *Wisselbank*) in 1609, whose operations superseded to a large extent, those of the moneychangers.<sup>56</sup>

(*ibid* at 112, by reference to 98, fn 244). The example given is of a situation in which the transferee was identified in the original cheque, ie, the payee was authorized to transfer the cheque to a specified transferee, from which I gather that no further transfer could have been made. This is of course a far cry from free circulation. I relied on an informal partial translation of Melis.

<sup>52</sup> See in general, De Roover, 'New Interpretations', above n 3 at 216–17 as well as Usher, *Deposit Banking*, above n 8 at 90–94. For an extensive discussion, see M Spallanzani, 'A Note on Florentine Banking in the Renaissance: Orders of Payment and Cheques' (1978), 7:1 *Journal of European Economic History* 145. The author points out (eg at 146) the difficulty in identifying with certainty those payment orders which are cheques. Furthermore, his definition of 'cheque' (at 148), as 'an order of payment issued on a bank . . . by someone who has funds available' is too broad and in effect does not distinguish between cheques and other payment orders. At the same time, my overall impression from the article is that he speaks of a 'cheque' in the correct sense.

<sup>53</sup> Usher, *Deposit Banking*, *ibid* at 91, referring in the quoted language to the depositor-drawer as 'creditor' (of the bank) and to his own (the 'creditor'-depositor-drawer's) creditor, namely to the payee, as the 'third party'.

<sup>54</sup> For the endorsement of the bill of exchange, see below section 5 of this chapter.

<sup>54.1</sup> 'By the 1690s Amsterdam was the world capital of financial innovation.' See N Ferguson, *The Ascent of Money: A Financial History of the World* (New York: Penguin Press, 2008) at 127.

<sup>55</sup> All quotes in this paragraph are from P Dehing and M 'T Hart, 'Linking the Fortunes: Currency and Banking, 1550–1800' in M 'T Hart, J Jonker and JL Van Zanden (eds), *A Financial History of the Netherlands* (Cambridge: Cambridge University Press, 1997) at 37, 43. See also P Spufford, 'Access to Credit and Capital in the Commercial Centres of Europe' in K Davids and J Lucassen (eds), *A Miracle Mirrored: The Dutch Republic in European Perspective* (Cambridge: Cambridge University Press, 1995) at 303, 306.

<sup>56</sup> P Dehing and M 'T Hart, *ibid* at 43–44, note that with the establishment of the Bank of Amsterdam in 1609 'the municipal authorities of Amsterdam temporarily prohibited all money changers and cashiers and their paper money'. The ban was lifted in 1621 'and the remaining money changers and cashiers became licensed officials.' However, in this new capacity, cashiers were required to hold accounts with the Bank of Amsterdam and were prohibited from keeping money in specie for longer than 24 hours. For the Bank of Amsterdam, see below.

Indeed, throughout the Continent, during the fifteenth century, private deposit banks declined. Repeated bank failures undermined the confidence of merchants and further triggered hostility by public authorities.<sup>57</sup> Together with a chronic shortage of good coins, increased risk in keeping money with a banker led to a devaluation of 'bank money' compared to that of 'coined money'.<sup>58</sup>

Prohibitions against private deposit and transfer banking were further prompted by the perception of authorities throughout Europe that 'money-changers acting as deposit bankers' threatened 'the integrity of the ducal mints and coins.' This threat was premised on the allegation that they were involved in 'circulating debased and counterfeit foreign coins and buying coin and bullion for export' in violation of restrictions over coinage and trade in precious metal.<sup>59</sup> Ultimately, in a process that 'did not gain momentum until the last quarter of the sixteenth century', public banks gradually replaced private banks in commercial centres.<sup>60</sup> Heraldng this development, Venice gave rise to a 'distinctive style' of banking, referred to as giro banking, under which the primary purpose of banks was the making of payments on behalf of customers rather than making loans.<sup>61</sup>

Continental public banks that followed and expanded on this model were Exchange banks, at which bills of exchange, discussed in the following section, were required to be payable, so as to compel merchants to open accounts with them.<sup>62</sup> Otherwise, these banks were predominantly deposit and transfer banks. In that capacity, some allowed the use of cheques (or 'assignments');<sup>63</sup> others insisted on oral orders in the presence of all parties. At the same time they were originally precluded and later strictly restricted from lending or making investments. At most, they were allowed to make advances to their own governments and to certain select institutions; the extension of credit to others, by way of

<sup>57</sup> De Roover, 'New Interpretations', above n 3 at 219.

<sup>58</sup> FC Lane, *Venice A Maritime Republic* (Baltimore: John Hopkins University Press, 1973) at 328–29 (hereafter: Lane, *Venice*); for the same phenomenon in Venice at a later period see *ibid* at 402. See also FC Lane, 'Venetian Bankers, 1496–1533: A Study in the Early Stages of Deposit Banking' (1937), 45 *Journal of Political Economy* 187 at 200–01 (hereafter: Lane, 'Venetian').

<sup>59</sup> Munro, above n 13 at 548, speaking of fifteenth-century 'economically advanced Low Countries'.

<sup>60</sup> De Roover, 'New Interpretations', above n 3 at 223. For the public bank in Venice as a successor of the private bank system, that failed primarily due to excessive lending by means of simple book entries, see CF Dunbar, 'The Bank of Venice' (1892), 6 *Quarterly Journal of Economics* 308; and G Luzzatto, 'Les Banques Publiques de Venise (Siècles XVI–XVIII)' in JG Van Dillen (ed), *History of the Principal Public Banks* (London: Frank Cass, 1964, being 2nd impression of the 1934 1st edn, The Hague: Martinus Nijhoff, 1934) at 39.

<sup>61</sup> FC Lane, *Venice*, above n 58 at 147. See also Lane, 'Venetian', above n 58 at 187 specifically rejecting earlier such institutions and stating that 'Giro banks did not come into existence until the late sixteenth century, at Venice in 1584'.

<sup>62</sup> Eg, for the Bank of Amsterdam (founded at the beginning of the seventeenth century) and discussed further below, see JG Van Dillen, 'The Bank of Amsterdam' in Van Dillen (ed), above n 60 at 79, 84.

<sup>63</sup> See eg for the Bank of Amsterdam, Van Dillen, *ibid* at 86 where it is further stated that '[t]he assignments should be handed in by the customer personally or by his proxy.'

overdraft or otherwise, was however strictly forbidden.<sup>64</sup> In that sense, they did not provide financial intermediation and were not ‘banks’ in the full modern sense of the word.<sup>65</sup>

Public banks provided an efficient machinery for local payments by means of book transfers. Not infrequently, the ‘bank money’ deposited with public banks was of higher value than the same amount in coined money.<sup>66</sup> This was so because ‘it represented money exactly according to the standard of the mint.’ Such ‘bank money’ was further secure from fire, robbery, and accidents; it was also easily transferable;<sup>67</sup> it reduced risk and was part of a system that reasonably provided adequate good coined money to satisfy actual demand for it.<sup>68</sup>

The Bank of Amsterdam, ‘established in 1609 under the guarantee of the city’,<sup>69</sup> was a leader among the public banks.<sup>70</sup> Balances kept with it were denominated in a ‘banco florin’; a unit of account of ‘bank money’, assessed by reference to a full-bodied (‘heavy’) coin. At the same time, ‘current money’, consisting of actual (mostly debased) coins, was circulating at a lower value of the ‘current (or cash) florin’, a unit of account set by reference to the intrinsic value of a ‘standard’ debased (‘light’) coin. To avoid a small withdrawal fee charged by the Bank, a market developed for a direct exchange between ‘bank money’ and ‘current money’, namely, between balances in the Bank and actual coins. The exchange rate between these two types of money ‘was measured by the premium on bank money, known as the *agio*.’<sup>71</sup>

Coins and bullion deposited with the Bank of Amsterdam were credited to an account, at a value that was determined by reference to their intrinsic value.

<sup>64</sup> De Roover, ‘New Interpretations’ above n 3 at 228. This is consistent with the description given by G Malynes, *Consuetudo, Vel Lex Mercatoria* or *The Ancient Law-Merchant* (London: Printed by Adam Islip, 1622) [Electronic Resource] at 133 as to the use of ‘money . . . remaining in the Bankers hands’.

<sup>65</sup> For these banks, see Van Dillen (ed), above n 60.

<sup>66</sup> JG Van Dillen, ‘The Bank of Amsterdam’ in Van Dillen (ed), above n 60 at 79, 88 specifically speaks of ‘banco-florin’ or ‘banco-money’ as distinguished from the inferior metallic ‘current florin’ or ‘current money’. See further below.

<sup>67</sup> Adam Smith, *The Wealth of Nations* (Chicago: University of Chicago Press, 1976; being the 1776 original text, edited by E Cannan and prefaced by GJ Stigler, ‘Two Volumes in One’) vol 1 at 504 in relation to the Bank of Amsterdam; cited in agreement (as ‘Adam Smith, Bk. Iv, chap. iii’) by Holdsworth, above n 20 at 180.

<sup>68</sup> This is in contrast to the reverse fifteenth-century process devaluating bank money set out at text and nn 57–58 above.

<sup>69</sup> Adam Smith, above n 67 at 504.

<sup>70</sup> See eg JG Van Dillen, ‘The Bank of Amsterdam’ in Van Dillen (ed), above n 60 at 79; Adam Smith, *ibid* at 503–13; P Dehing and M ’T Hart, ‘Linking the Fortunes: Currency and Banking, 1550–1800’ in M ’T Hart et al, above n 55 at 45–51; and S Quinn and W Roberds, ‘The Big Problem of Large Bills: The Bank of Amsterdam and the Origins of Central Banking’, 22 January 2007 [Unpublished; for a former version, see Federal Reserve Bank of Atlanta, Working Papers Series, Working paper 2005–16 August 2005 (albeit the latter contains lots of econometrics which is inaccessible to a non-specialist such as myself)]. For money and banking in Amsterdam see also J De Vries and A Van Der Woude, *The First Modern Economy: Success, Failure, and Perseverance of the Dutch Economy, 1500–1815* (Cambridge: Cambridge University Press, 1997) at 81–91, 129–34.

<sup>71</sup> Quinn and Roberds, *ibid* at 10.

Under a system that was introduced in 1683,<sup>72</sup> all such deposits were receipted. A receipt was good for six months, but was renewable, at the expiration of each six months, against the payment of a small fee, 'a sort of warehouse rent'.<sup>73</sup> The failure to pay the fee triggered the expiry of the receipt; this led to the forfeiture of the cash withdrawal privilege for the receipted amount, albeit not of the right to use of the corresponding balance as 'bank money'. Coin withdrawals of amounts deposited, could be made only against such unexpired valid receipts. Unexpired receipts could be sold against balances in the Bank and were traded. Large-value bills of exchange, of at least 600 Florins,<sup>74</sup> payable in Amsterdam could not be paid in coins, but rather, only by means of a credit posted to an account with the Bank.<sup>75</sup> Settlement at the Bank of Amsterdam took place daily on a multilateral basis; merchants were effectively required to use accounts with the Bank, albeit at times, merchants having accounts with 'cashiers' could use their cashiers' accounts maintained at the Bank for the payment of bills of exchange. However, on the whole, merchants mistrusted cashiers and saw them as prone to failure and fraud.<sup>76</sup> In theory, metallic value was kept in the coffers of the Bank and provided a full reserve for all balances credited to accounts.<sup>77</sup> The Bank's revenue was thus made out of bank charges.<sup>78</sup>

Continental public banks that followed this model were banks of circulation, allowing the credit available on their books to their customers to be used in payment from one customer to another, regardless of whether such bank credit resulted from deposits in coin or advances made by the bank to customers entitled to receive such advances.<sup>79</sup> However, unlike their successor, the Bank of England, discussed below in chapter ten, they did not issue paper money in the form of banknotes and thus were not banks of issue.

<sup>72</sup> P Dehing and M 'T Hart, 'Linking the Fortunes: Currency and Banking, 1550–1800' in M 'T Hart et al, above n 55 at 48. See also Quinn and Roberds, *ibid* at 10.

<sup>73</sup> Adam Smith, above n 67 at 506. The rate varied depending on the metal.

<sup>74</sup> According to P Dehing and M 'T Hart, above n 55 at 46, the amount was reduced in 1643 to 300 Florin (guilders).

<sup>75</sup> Effectively then, such large-value payments were paid in the higher 'banco florin', in which balances at the Bank were denominated. At the same time, in principle, low local non-cash payments, between those who did not maintain accounts at the Bank, could be carried out through accounts kept with cashiers, and were denominated in the lower 'current money,' as if they were cash payments. See Quinn and Roberds, above n 70 at 10. For the limited cashiers' permissible operations after the establishment of the Bank, see n 56 above. I did not come across any analysis of transfers between customers of two such cashiers who, for their part, must have settled on the books of the Bank of Amsterdam (where they were required to maintain their own accounts).

<sup>76</sup> For both the daily multilateral settlement and the mistrust of merchants in the cashiers, I relied on an unofficial translation from WC Mees, *Proeve eener Geschiedenis van het Bankwezen in Nederland gedurende den Tijd der Republiek*, 'Attempt at a History of Banking in the Netherlands During the Time of the Republic' (Rotterdam: W Messchert, 1838) at 124–25 and 130–31 [in Dutch].

<sup>77</sup> In fact, from a depositor's perspective, this was a true 'irregular deposit' under Roman law, as discussed above in ch 5, section 2.

<sup>78</sup> Accordingly, fees were charged for opening an account as well as each transfer, not to mention for the 'warehouse rent'. For specific rates, see Adam Smith, above n 67 at 512.

<sup>79</sup> Luzzatto, above n 60 at 57–58; De Roover, *Lettre de Change*, above n 42 at 139.

There were however a few exceptions. Thus, Neapolitan, Sicilian, and Genoese banks issued a transferable credit instrument, called *fede di credito*, which was akin to a certificate of deposit or bank draft. This document did not freely circulate; rather, it was transferred by delivery accompanied by the signature of the payee authenticated by a notary, which was an awkward procedure designed to prevent fraud.<sup>80</sup> Nevertheless, greater significance is to be attributed to exceptions that developed in practice. For example, in the footsteps of its predecessors, the 'cashiers', the Bank of Amsterdam allowed not only the withdrawal of cash by means of *assignaties*, or written cheques; rather, and again, in the footsteps of the 'cashiers', it also issued to depositors receipts transferable by endorsement and ultimately payable to bearer so as to be 'only a short distance [from] the creation of bank-notes'.<sup>81</sup> As well, it is clear that Bank of Amsterdam actually extended credit out of deposited funds. Particularly, it made loans to the city of Amsterdam (its parent), to the municipal pawnshop, and on a very short-term basis to the Dutch East India Company.<sup>82</sup> According to one view, it originally lent only out of deposited money for which receipts expired, so that it was not withdrawable.<sup>83</sup> At the same time, the amount of such deposits must have been small; the lending practice must have been of greater dimensions, so that in the final analysis, it was the substantial debt owed by the Dutch East India Company that largely contributed to the decline of the Bank of Amsterdam.<sup>84</sup>

Most significant exceptional features characterized the Bank of Sweden, founded in the middle of the seventeenth century.<sup>85</sup> Developing some less prominent aspects of the Bank of Amsterdam, the Bank of Sweden had extensive credit operations, albeit not necessarily always in compliance with official regulations. The Bank lent money to customers out of both demand and interest bearing term-deposits, and became obligated in excess of its metallic reserve. Moreover, the Bank of Sweden also experimented with banknote issue; its 'notes were partly certified cheques' drawn on it, 'partly a sort of certificates of deposits.' However, the note-issue was 'against the wishes of [its] leaders . . . , and had never acquired any importance.'<sup>86</sup> As well, loans were made by the

<sup>80</sup> De Roover, 'New Interpretations', above n 3 at 224–25. Since the issuer was the bank itself and not the customer, this was more of a bank draft or cashier's cheque than a certified cheque, as proposed by De Roover, *ibid*.

<sup>81</sup> Spufford, above n 55 at 307.

<sup>82</sup> Spufford, *ibid* at 306.

<sup>83</sup> Adam Smith, above n 67 at 511. However, as noted above in text at n 72, the receipt system commenced only in 1683, more than 70 years after the establishment of the Bank, albeit more than 100 years before its downfall at the end of the eighteenth century.

<sup>84</sup> See eg Quinn and Roberds, above n 70 at 33–34. But cf H Thornton, *An Inquiry into the Nature and Effects of the Paper Credit in Great Britain* (1802) (New York: AM Kelley, 1962, edited with Introduction by FAV Hayek), claiming at 107 (2nd fn) that the Bank of Amsterdam used to secretly (and unlawfully) lend to the city of Amsterdam and the Dutch government and that (at the time this was written), '[n]either of the two debts . . . have yet been discharged'.

<sup>85</sup> See EF Heckscher, 'The Bank of Sweden' in Van Dillen (ed), above n 60 at 161, particularly at 171–77.

<sup>86</sup> *Ibid* at 178. Nonetheless, these notes were 'Europe's first freely circulating banknotes.' See C Eagleton and J Williams, *Money: A History*, 2nd edn (London: British Museum Press, 2007) at 179.

Bank against the security of land, so that 'the Bank was unimportant with regard to commercial credit'.<sup>87</sup> In the final analysis, the principal significance of the Bank of Sweden to the 'trading world' was, as that of all other public banks, in 'taking care of . . . cash and facilitating methods of payment.'<sup>88</sup>

The public bank system survived in Europe until the end of the eighteenth century. Subsequently, it was superseded by the English banking model discussed in chapter ten below. It is argued that transformation in the eighteenth and nineteenth centuries was facilitated by liquidity enhancement in the form of note issuing and bill discounting, functions that appeared in the seventeenth century and acquired dominance only subsequently, and that certainly did not characterize the activities of public banks.<sup>89</sup> Thus, traditionally, the legacy of the public banks has been linked to the facilitation of safe custody to money, the solidification of 'bank money', and the provision of a reliable non-cash payment system, all of which preserved and enhanced past accomplishments of the Medieval private deposit and transfer banking.

However, institutions such as the Bank of Amsterdam and the Bank of Sweden also had features that broke away from the standard model. Particularly, they went beyond the provision of accounts denominated in standardized currency facilitating book transfers. Rather, they also allowed for lending out of deposits so as to become obligated in excess of metallic reserves. Thereby, they laid down foundations to what subsequently developed in England to herald the modern banking and payment system.<sup>90</sup> In the final analysis, then, the rejection of the fractional reserve was the rationale for the emergence and evolution of public banks and to their provision of good money and the secure payment system. At the same time, a renewed adherence by some of them, albeit tentative and cautious, to the fractional reserve, while not abandoning the provision of good money and secure non-cash payments, contributed to the transformation.

### 3. HERALDING THE BILL OF EXCHANGE: THE MEDIEVAL CONTINENTAL BILL OF PAYMENT

As indicated in section 2 above, the word 'bank' comes from the table of the moneychanger, who became a local banker. At the same time, international Medieval banking is primarily associated with the exchange activity of merchant bankers. This activity gave rise to the modern bill of exchange.

<sup>87</sup> Heckscher, above n 85 at 176. Indeed, '[l]oans against commodities were difficult to arrange, and loans against personal property were excluded altogether.' *Ibid* at 175.

<sup>88</sup> Heckscher, *ibid* at 176.

<sup>89</sup> Lane, 'Venetian', above n 58 at 187 as well as Lane, *Venice*, above n 58 at 330. For the origins of 'negotiability' and bill discounting see section 5 of this chapter. For the transformation of banking, see below in ch 10.

<sup>90</sup> For this conclusion, see Ferguson, above n 54.1 at 48–49.

Under modern legislation,<sup>91</sup> the bill of exchange (or draft) is an unconditional written signed order, addressed by one person to another, requiring the person to whom it is addressed to pay a certain sum in money. It may be payable to the order of a designated payee or (though not everywhere) to the bearer, on demand or at a fixed or determinable future time.<sup>92</sup> It may be transferred from one person to another by 'negotiation', consisting of either a mere delivery in the case of a bill payable to the bearer, or of delivery plus the transferor's signed 'endorsement'<sup>93</sup> in the case of a bill payable to the order.<sup>94</sup> Under certain conditions,<sup>95</sup> it may be enforceable by its holder for its entire sum, free of a third party's adverse claims, as well as of any party's contract defences.<sup>96</sup> The instrument is called 'negotiable' due to its transferability by 'negotiation' and the power of 'negotiation' to 'improve' on the transferee's title.<sup>97</sup> Throughout its history it has served as a credit and payment mechanism.

De Roover identified three stages in the history of the bill of exchange from its inception to the end of the eighteenth century. The first stage lasted approximately from 1275 to 1350. At that stage liability on the bill of exchange required

<sup>91</sup> Particularly the English *Bills of Exchange Act, 1882* (UK), 45 & 46 Vict, c 61 (hereafter: BEA), on which legislation throughout the world is modelled in common law jurisdictions and others that have been under British influence; *Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes*, 7 June 1930, 143 L.N.T.S. 257, Annex I, on which legislation throughout the world is modelled in civil law countries including those in Continental Europe (hereafter: Geneva Bills Convention); the American Art 3 of the *Uniform Commercial Code* (1990, as amended 2002) (hereafter: U.C.C. Article 3); and 'United Nations Convention on International Bills of Exchange and International Promissory Notes' (UN Doc A/RES/43/165) in *Yearbook of the United Nations* 1988 (New York: UN, 1988) vol 42 at 834 (hereafter: UNCITRAL Bills Convention).

<sup>92</sup> Relevant provisions, in each case in conjunction with immediately ensuing ones, in each of the sources cited in the immediately preceding note, are BEA s 3(1); Geneva Bills Convention art 1; U.C.C. §3-104; UNCITRAL Bills Convention art 3(1) (the latter two do not cover a bill stated to be payable to bearer).

<sup>93</sup> According to JM Holden, *The History of Negotiable Instruments in English Law* (London: University of London: The Athlone Press, 1955, reprint 1993, WM W Gaunt & Sons) at 44, fn 6, '[t]he spelling "endorse", is more common than "indorse" in commercial practice'. At the same time, he goes on to say, '[t]he *Bills of Exchange Act, 1882*, adopted the spelling "indorse".' *Ibid.* I should add that on that point U.C.C. Article 3 follows suit and uses 'indorse'. In contrast, the Canadian spelling, reflected in the *Bills of Exchange Act*, R.S.C. 1985, c. B-4, and adopted in this text, is 'endorse'.

<sup>94</sup> BEA s 31; Geneva Bills Convention art 11; U.C.C. §3-201; UNCITRAL Bills Convention art 13. The term 'negotiation' appears only in the BEA and U.C.C. Article 3, *ibid.* An endorsement which does not designate the transferee is an endorsement in blank, which effectively 'converts' the bill into one payable to the bearer. This is true even where instruments originally issued payable to the bearer are not recognized (as discussed in n 91 above). For the 'conversion' by blank endorsement of the bill payable to order see eg BEA s 34(1); Geneva Bills Convention arts 12–13; U.C.C. §3-205; UNCITRAL Bills Convention arts 13–16. For the cite of each of the four sources, see n 91 above.

<sup>95</sup> Fundamentally, these conditions refer to the taking of the instrument by the holder in good faith, without knowledge, and for value. See eg BEA s 29(1); Geneva Bills Convention arts 16–17; U.C.C. §3-302; UNCITRAL Bills Convention art 29. *Ibid.*

<sup>96</sup> See eg BEA s 38(2); Geneva Bills Convention arts 16–17; U.C.C. §§3-305 and -306; UNCITRAL Bills Convention art 30. *Ibid.*

<sup>97</sup> For an extensive discussion on the negotiability concept and the definition of a negotiable instrument, see DV Cowen and L Gering, *Cowen on the Law of Negotiable Instruments in South Africa*, 5th edn, vol I: General Principles (Cape Town: Juta, 1985) at 1–70.



a notarial confirmation of the signature.<sup>98</sup> This requirement disappeared in the second stage which lasted until the end of the sixteenth century. With the disappearance of the notarial requirement, the instrument nevertheless retained some formal language,<sup>99</sup> and yet had become an ordinary 'informal letter',<sup>100</sup> written by non-lawyers and without the benefit of legal advice, as part of ordinary commercial correspondence between merchants.<sup>101</sup> This is in fact the source of the reference to the instrument as a 'letter' rather than the more legalistic 'bill' which disappeared in English but which has survived in the French language to this day. During these first two periods, the bill of exchange served as an evidentiary document required for the execution of the exchange contract, whose features are discussed shortly below. The third stage lasted until close to the end of the eighteenth century. During that stage, the instrument acquired its negotiability features; particularly, it became transferable either by delivery alone, or by delivery and endorsement, and gradually lost its connection to the exchange contract.<sup>102</sup>

This section deals with the first two stages of the instrument, during which it is referred to below as a bill or letter of payment.<sup>103</sup> This is not to claim that during this period the instrument did not serve also as a credit facility. Rather, the instrument is referred to as a bill or letter of payment with the view to distinguishing it from its successor, the negotiable bill of exchange, which emerged in the third stage of the development of the instrument. As well, the title 'bill or letter of payment' stresses the function of the instrument as facilitating a non-cash payment mechanism, which is of most interest in this study.<sup>104</sup> The section also analyses the principal features of the mechanism for the settlement of obligations on bills of payments in the Middle Ages. That Medieval mechanism is the forerunner of the modern interbank clearing and settlement system operating in an organized multilateral setting. Section 4 then deals with the legal relationships under the bill of payment. Subsequently, section 5 explores the

<sup>98</sup> For the early bill of payment as a notarial instrument, see eg AE Sayous, 'L'Origine de la Lettre de Change' (1933), 12 (Ser 4) *Revue Historique de Droit Français et Étranger* 66; AE Sayous, 'Note sur l'Origine de la Lettre de Change et les Débuts de son Emploi à Barcelone (XIV<sup>e</sup> siècle)' (1934), 13 (Ser 4) *Revue Historique de Droit Français et Étranger* 315; and Sayous, 'Méthodes Commerciales XV', above n 8 at 274–86.

<sup>99</sup> MT Boyer-Xambeu, G Deleplace and L Gillard, *Private Money & Public Currencies – The 16th Century Challenge*, trans by A Azodi (New York and London: ME Sharpe, 1994) at 30.

<sup>100</sup> Origo, above n 20 at 147.

<sup>101</sup> Sayous, 'Méthodes Commerciales XV', above n 8 at 276. Notarial requirement reappeared however in connection with a proof of dishonour. *Ibid* at 285.

<sup>102</sup> De Roover, *Lettre de Change*, above n 42 at 18–19. He enumerates two subsequent periods, one of expansion, in the nineteenth century during which the bill of exchange became discountable, followed by a subsequent contraction in terms of actual use.

<sup>103</sup> Huvelin, 'Travaux', above n 37 at 5. Cf De Roover, *Lettre de Change*, above n 42 at 40. An earlier variation was known as a bill or letter of fair ('*lettre de foire*'). See eg MG Des Marex, 'La Lettre de Foire au XIII<sup>e</sup> Siècle' (1899), 12 *Revue de Droit International et de Législation Comparée* 533; and AP Usher, 'The Origin of the Bill of Exchange' (1914), 22 *Journal of Political Economy* 566 at 566 (hereafter: Usher, 'Origin').

<sup>104</sup> At the same time, as will be seen further below in this section, the instrument was predominantly a credit facility.

acquisition of negotiability features by the bill or letter of payment, so as to 'perfect' the instrument into the bill of exchange as we know it today.

The bill or letter of payment existed, and probably originated as a mechanism for the execution of the Medieval contract of *cambium*.<sup>105</sup> Adoption for that use is not contested by those claiming earlier ancestry,<sup>106</sup> whose views are in any event strongly contested.<sup>107</sup> The *cambium* contract has three meanings, all of which denote certain exchanges.<sup>108</sup> First, in its broadest Romanist jurisprudential sense, it is a contract by which a species of one genus is exchanged for another species of the same genus. Second, in a narrower sense, it is a contract for the exchange of money for money. Third, in the narrowest sense, it is a contract for the exchange of money of one currency with money of another currency and the transportation of the money received to another place. However, as will be outlined below, transportation need not necessarily be physical; in this context, it is more accurate to speak of the 'transportation' – or in fact, transmission – of the *sum* of money rather than of the money. In essence, here lies the explanation of the *cambium* contract as a payment mechanism.

In its broadest sense, as a contract for the exchange between two species of the same genus, *cambium* is a sub-category of barter, or *permutatio*. The latter denotes an exchange in general, which otherwise is concerned with the exchange of a species of one genus with a species of another genus.<sup>109</sup>

Certainly, what may be one genus, and hence, the application of the *cambium* contract in a given case, may well be in the eyes of the beholder. In Roman law, the basic distinction between a genus and a species is that the former is a kind; a group of things with common qualities; while the latter is an individual or specific thing. Genus indicates fungibility, or interchangeability among various individual objects, of which each can be replaced by another of the same quality or description. A species is any one specific item.<sup>110</sup> However, there is no clear-cut test for determining how much commonality is required for things to fall into one genus. Obviously, this is crucial as to whether a barter transaction is a

<sup>105</sup> De Roover, 'New Interpretations', above n 3 at 203. For the origins of the bills of exchange in Medieval international trade practices, see also Boyer-Xambeu et al, above n 99 at 17.

<sup>106</sup> For a review of such views, see Huvelin, 'Travaux', above n 37 at 5–9.

<sup>107</sup> De Roover, *Lettre de Change*, above n 42 at 12–17.

<sup>108</sup> A possible fourth meaning, effectively overarching the second and third meanings, is any contract dealing with money or credit as opposed to merchandise (or logically, also to services). See P Huvelin, 'Travaux', above n 37 at 2.

<sup>109</sup> According to Berger, 'Permutatio' is '[t]he exchange of one thing for another, a barter. It differs from sale in that instead of money a thing is given as compensation. *Permutatio* is an innominate contract . . . not concluded by mere consent of the parties, as sale, but by an actual, real . . . transfer of ownership from one party to another.' A Berger, *Encyclopedic Dictionary of Roman Law* (Philadelphia: American Philosophical Society, 1953) at 628. In Roman law, a contract whose nature is difficult to determine, but which is undoubtedly binding, as eg, where it falls on the borderline between two types, is an 'innominate' contract. See RW Lee, *The Elements of Roman Law with a Translation of the Institutes of Justinian*, 4th edn (London: Sweet & Maxwell, 1956) at 340–42. For the broader context of contracts in Roman law, see ch 5, section 1. *Cambium* is not known in Roman law and thus is not defined by Berger.

<sup>110</sup> See eg Berger, *ibid* at 482 (v. 'Genus') and 712 (v. 'Species').

*cambium* contract. For example, if ‘apples’ but not ‘fruits’ constitute one genus, the exchange between apples is under a contract of *cambium*, but not the exchange between apples and oranges. In that context, each apple is a species of the same genus, while apples and oranges constitute different species each of a distinct genus. Conversely, if fruits form one genus, the exchange between apples and oranges, as two species of that genus, is not different from the exchange between two apples, so as to be equally covered by the *cambium* contract.

To that end, in connection with money, one may ask as to whether each currency is a genus, so that the contract of *cambium* covers only the exchange between coins or denominations of a single currency, each such coin or denomination being a species of that genus. Or, alternatively, the question is whether money in general constitutes a genus, so that the *cambium* contract is broad enough to cover any monetary exchange, including one involving different currencies, all of which constitute distinct species of one genus.

It is the second view that prevailed. Thus, on the exchange of money, no line is drawn between *cambium* and the more general *permutatio*. Rather, money, in whatever currency or denomination, is thought to form one genus, so that each denomination, coin, or currency is a species of it. Hence, in its second sense, as applied to money, the medieval contract of *cambium* is said to cover the exchange of money for money in general.

In this second sense, as the exchange between two species of money, the contract of *cambium* covers three types of monetary exchange:<sup>111</sup>

- First, it is the physical or manual exchange of money for money, whether in different currencies or only different denominations of the same currency. This is the money-change transaction, for the exchange of coins, known as *cambium minitum*, already referred to in this study in various places;<sup>112</sup>
- Second, it is a loan extended in one currency at one place, to be repaid in another currency at another place. As will be seen immediately below, this monetary exchange was a source of inspiration to both an illegal transaction in the form of the dry exchange, and the foundation for the emergence of the bill of exchange; and
- Third, it is the dry exchange, namely, *cambium siccum* or ‘secke or drye exchange’, or in one form *cambium fictivum*, or fictitious exchange.<sup>113</sup> Thereunder, a loan extended in one currency at one place is ostensibly to be repaid in another currency at another place, as in the monetary exchange transaction between two species of currencies falling into the second meaning of *cambium* just discussed above. However, while in the transaction falling

<sup>111</sup> See eg Holdsworth, above n 20 at 126–27.

<sup>112</sup> Eg, see ch 2, section 2.2; and ch 3, section 3 above.

<sup>113</sup> See in detail, De Roover, ‘Dry Exchange’, above n 32; and De Roover, ‘Cambium ad Venetias – Contribution to the History of Foreign Exchange’ in J Kirshner (ed), *Business, Banking, and Economic Thought in Late Medieval and Early Modern Europe: Selected Studies of Raymond de Roover* (Chicago and London: University of Chicago Press, 1974, Phoenix Edition 1976) (hereafter: De Roover, ‘Cambium ad Venetias’).

under the second meaning the contracting parties intend repayment to be carried out as contracted, this is not their intent in a transaction falling under this third meaning. Rather, the intent is to convert back repayment to the original currency and place of contract, with the lender profiting from the double conversion, receiving more than lent in the very same original currency of the loan. The operation of this mechanism is described below in further detail,<sup>114</sup> once the features of the genuine exchange are set out.

It is the genuine execution of the second type of monetary exchange which gave rise to the bill or letter of payment. That is, in the narrowest sense, to be used in the ensuing discussion, unless indicated otherwise, the *cambium* or exchange contract is effectively a contract for the loan of money to be repaid in a currency and at a place other than those of the loan itself.<sup>115</sup> However, Medieval doctrine did not treat the exchange as a loan, though from the economic perspective, it certainly involves the extension of credit, so as to constitute in substance a loan.<sup>116</sup> Rather, in the eyes of Medieval doctrine, the *cambium* or exchange contract involves a genuine exchange between two currencies at a rate reflecting a market price. It further involves the transportation of the money from place to place.<sup>117</sup> Hence, it was exempted from usury laws; the latter regulated only the compensation for a loan, that is, the 'certain gain' for use of money, and neither the price for its transportation from place to place nor its exchange to a different currency.<sup>118</sup> In any event, cost of transportation was neither explicit nor a factor in the determination of the rate; the conventional wisdom is that it merely set the limits within which the exchange rate between the two currencies fluctuated.<sup>119</sup> The *cambium* or exchange contract was then a simple and genuine

<sup>114</sup> See text around n 161 below.

<sup>115</sup> Interestingly enough, both Sayous ('Méthodes Commerciales XV', above n 8 at 275) and De Roover ('Cambium ad Venetias', above n 113 at 241) do not rule out the possibility of repayment in the same currency (though always in another place), at least as an exception. And yet neither the former nor the latter analyses this possibility, either from the perspective of the application of usury law or otherwise.

<sup>116</sup> De Roover, *Lettre de Change*, above n 42 at 19–21.

<sup>117</sup> Whether the instrument originated as a machinery for transfer, exchange, or the extension of credit, is discussed by Sayous, 'Méthodes Commerciales XII et XIII', above n 8 at 316–17.

<sup>118</sup> Regarding the application of usury laws, two observations are to be made. First, a charge for a loan repayable in the currency and place of the loan was usurious as it compensated the lender for the use of the money lent. Having involved the exchange between two sets of specific coins, even of different denominations, it was nevertheless not exempted from usury laws. Second, unlike Islamic law (ch 6, section 3.4) and in the footsteps of Jewish law (ch 7, section 5), Christians did not seem to regard the allocation to the borrower of the risk of loss in transportation as an unlawful gain to the lender in violation of usury laws. Hence, in the case of the Continental letter of payment, involving a loan to be repaid in a place and currency other than of the loan, usury laws did not apply. *Quaere* as to why usury law possibly applied where only one element was present, that is, in connection with either a loan to be repaid locally in another currency or a loan to be repaid in another place in the currency of the loan. Resolution of this issue is beyond the scope of the present study. As it happened, the historical Continental letter of payment involved repayment of the loan in both a different place and according to a different currency so as to be exempted from usury laws.

<sup>119</sup> De Roover, *Lettre de Change*, above n 42 at 11, fn 1 (where author is sceptical as to the accuracy of that conventional wisdom).

currency exchange for which a charge may be fastened as determined at a rate expressing the different value of each currency.

The alternative view was to treat the *cambium* contract not as that of *permutatio* or barter, but rather that of an *emptio venditio*,<sup>120</sup> namely, of purchase and sale. This is reminiscent of the approach of the Jewish Talmud, treating the exchange of coins as a form of sale of goods for money, in which one set of coins is the merchandise and the other is the money.<sup>121</sup> Similarly, according to this alternative Romanist view, under the *cambium* contract, 'absent' money is the thing purchased and sold; it is to be delivered elsewhere, at a specified future time, and for a price paid in 'present' money at the time and place of the conclusion of the transaction.<sup>122</sup> As in connection with *permutatio*, or barter, the transaction was not considered to be a loan, but rather constituted a genuine sale, and as such was exempt from usury laws. In this context, it is thus the genuine execution of this sale that gave rise to the bill of payment.

In any event, the terminology of 'present' and 'absent' money, denoting the two currencies involved in the exchange, is not limited to the *emptio-venditio* theory for the *cambium* contract. Rather it is equally applicable to the *permutatio* or barter theory, under which 'absent' money is exchanged or bartered (rather than purchased and sold as under the *emptio-venditio* theory) in the *cambium* contract for 'present' money.

Originally, bills were payable at Medieval fairs, mostly those of Champagne. Fairs were however soon replaced by commercial centres. According to De Roover:<sup>123</sup>

By 1325 the rôle [sic] of the fairs of Champagne was played out . . . In the fourteenth and fifteenth centuries, the banking places of Europe were: Bologna, Florence, Genoa, Lucca, Milan, Naples, Palermo, Pisa, Siena, Venice, and the court of Rome in Italy; Avignon, Montpellier, and Paris in France; Barcelona, Valencia, and Palma de Mallorca in Spain; Bruges in Flanders; and London in England . . . Paris declined shortly after 1400 . . . as a result of the Hundred Years War, and its place was taken by the fairs of Geneva and, after 1465, by those of Lyons.<sup>124</sup> There were no banking places east of the Rhine, although the fairs of Frankfurt-on-the-Main began to emerge . . . toward the end of the fifteenth century<sup>125</sup>

<sup>120</sup> In general for this term, see Berger, above n 109 at 452 (v. 'Emptio venditio').

<sup>121</sup> See ch 2, section 2.2 above.

<sup>122</sup> De Roover, *Lettre de Change*, above n 42 at 116 as well as at 20 where he mentions another possibility, that of a *sui generis* contract. For the terminology of 'absent' and 'present' money see also see Boyer-Xambeu et al, above n 99 at 29.

<sup>123</sup> De Roover, 'New Interpretations', above n 3 at 205.

<sup>124</sup> For a map titled 'The European Triangle of Exchange by Bills during the Heyday of the Lyons Fairs, 1533–1575' see Boyer-Xambeu et al, above n 99 at 80. Cities linked to Lyon, and in some places, also bilaterally, are Palermo, Messina, Rome, Lucca, Florence, Venice, Milan, Genoa, Antwerp, London, Rouen, Median del Campo, Lisbon, Seville, and Valencia.

<sup>125</sup> However, there may not be universal agreement as to exact timing. Cf Bergier, above n 19 at 116–29, speaking of the 'irresistible' ascent of German banks to hegemony in the financial life of Europe as occurring between 1480 and 1520 or 1530.

Medieval bills were payable at sight, at so many days after sight, at so many days from date, and sometimes at the conclusion of a fair.<sup>126</sup> Typically, however, a bill was paid at *usance*; that is, it became due after a certain period of a fixed time determined by mercantile custom for each pair of commercial centres. It could also be paid either at a trifle lower rate at *half-usance* or trifle higher rate at *double-usance*. In each case, the amount to be repaid was fixed in advance; in theory it reflected the anticipated value of the loan in the currency measuring the repayment obligation according to the anticipated exchange rate upon maturity. However, in practice, it also included hidden interest charges to cover the use of the money actually lent. At the same time, not being based exclusively on the hidden interest charge, the rate of return to the lender was unknown,<sup>127</sup> as it depended on how the exchange rate would swing. In fact, a lender could even lose money in case of unanticipated fluctuations.<sup>128</sup> In other words, the transaction was speculative. Also for this reason usury laws did not apply, as they condemned only a certain profit on a loan, namely the assurance of remuneration without the assumption of risk.

Thus, the bill or letter of payment was a credit instrument facilitating the transportation of money from place to place, particularly in the execution of the payment obligation by the obligor of the exchange contract. As such, it gave the obligor the use of the money between receiving it at one place and paying it at another. It further relieved him from the risk of loss in transit. In other words, the bill 'was not only a loan instrument but also a remittance contract that "transferred funds", or more accurately, effected payments between distant cities without any movement of precious metals between them.'<sup>129</sup>

In practice, the bill or letter of payment served as an instrument for payment of debts incurred in commerce in a setting under which the caravan trade had been replaced by a sedentary commerce. In the former, the seller accompanied the goods. In the latter, the seller shipped them to a fair outside his place of business; that is, the merchant shipped goods to a foreign market in order to sell them there. To that end, he secured permanent representation in the foreign market by means of factors/agents, partners, or correspondents. In the sedentary commerce, the seller expected to be paid in a place and currency other than his. To that end, the bill or letter of payment served as a facility for both the transmission of funds or payment from place to place as well as for the conversion of one currency to another.<sup>130</sup>

<sup>126</sup> R De Roover, *The Rise and Decline of the Medici Bank, 1397–1494* (Cambridge, Mass.: Harvard University Press, 1963, 2nd printing 1968) at 110 (hereafter: De Roover, *Rise and Decline*). Already in the early period Sayous noted the rarity of bills payable on demand. Sayous, 'Méthodes Commerciales XV', above n 8 at 282. The sight bill did not become widespread until the seventeenth century. See Boyer-Xambeu et al, above n 99 at 40.

<sup>127</sup> De Roover, *Lettre de Change*, above n 42 at 55.

<sup>128</sup> De Roover, 'Cambium ad Venetias', above n 113 at 243.

<sup>129</sup> Munro, above n 13 at 543.

<sup>130</sup> For a detailed analysis in a broad context, see De Roover, 'The Organization of Trade', above n 10 at 42.

The document's roots are in a notarial instrument called an *instrumentum ex causa cambii*. It contained the authenticated signature of a debtor who thereby acknowledged receipt of money in local currency and promised to repay it elsewhere and in another currency. Such was the document originally used by Genoese bankers who usually promised to repay at the fairs of Champagne.<sup>131</sup> Over the years, particularly in light of the close circle of signers involved in issuing such documents and their familiarity with each other, the notarial requirement was abandoned. Nevertheless, adherence to form was preserved: a bill or letter of payment had been required to use 'exact formulas' and 'customary wordings' and must have been handwritten by its issuer, rather than a scribe.<sup>132</sup>

In the process, the notarial promise to pay transformed itself to a signed order<sup>133</sup> given to an agent or correspondent in the place of payment, who would then give the promise to pay by means of accepting the order. In terms of its contents, the bill or letter of payment is thus a written order given by the borrower, as the drawer of the letter. The drawer's order is addressed to a drawee. The drawer's order to the drawee is to pay to the payee, that is, the receiver of the letter. Payment to be made by the drawee is denominated in the designated 'absent' currency, and is to be made at the designated place of payment. This payment is in repayment of the loan received by the drawer/borrower from the remitter/lender, denominated in the 'present' currency, made at the place of the loan. To obtain payment, the payee is to present the document to the drawee either directly for payment, or first for acceptance and subsequently for payment. Endorsement was introduced in the course of the sixteenth century but did not become prevalent until the seventeenth century; hence, no practice of negotiation had been known, so that bills or letters of payment did not circulate.<sup>134</sup> To that end, from a legal perspective, it is inaccurate to refer to 'bills . . . bought and sold',<sup>135</sup> and not to speak of 'negotiating commercial paper'<sup>136</sup> which suggests complete instruments being transferred from one person to another; rather, bills were *issued* – and not 'sold' – by drawers/borrowers to remitters/lenders, who collected on them.<sup>137</sup>

Three points are noteworthy. First, as already indicated, carrying out the payment obligation on the bill or letter of payment did not involve the physical

<sup>131</sup> De Roover, 'New Interpretations', above n 3 at 203.

<sup>132</sup> Boyer-Xambeu et al, above n 99 at 30.

<sup>133</sup> P Huvelin, *Essai Historique sur le Droit des Marchés et des Foires* (Paris: Arthur Rousseau, 1897) (hereafter: Huvelin, *Essai*) speaks at 553–54 of an interim stage of two signed documents, one, being the foreign exchange contract, containing a promise to pay (directed to the remitter), and another, being the bill of payment, containing the order to pay in the execution of the contract contained in the first document.

<sup>134</sup> De Roover, 'New Interpretations', above n 3 at 221.

<sup>135</sup> See eg De Rover, 'Banking and Credit', above n 12 at 10. See also Boyer-Xambeu et al, above n 99 at 26 speaking of the drawer as a 'buyer of bills of exchange'.

<sup>136</sup> De Roover, *Rise and Decline*, above n 126 at 110.

<sup>137</sup> Eg, 'issue' is defined in BEA s 2 as 'the first delivery of a bill . . . , complete in form to a person who takes it as a holder' (above n 91). See also U.C.C. §3-105(a).



transportation of money. Rather, the instrument 'made it possible to transfer purchasing power without the shipment of actual coins.'<sup>138</sup> In this sense, the characterization of the bill or letter of payment as a contract for the transportation of money is misleading, or at least, is not to be taken literally. Rather, as outlined below, as a contract for the 'transportation' of a *sum* of money, it was a mechanism for a non-cash payment between two places. Thus, the characterization of the instrument as involving the transportation of money is a metaphor for its function and not a concrete description of its fulfilment.

Second, the currency conversion was the business context that gave rise to the facility; it is however not an inherent feature of it as a non-cash payment mechanism. Thus, for our purposes, in analysing the respective rights and duties of the participants in the payment transaction, the function of the letter of payment in the conversion of currencies can mostly be overlooked. Rather, the mechanism will be analysed as a facility for the transfer of funds from place to place. At the same time, the business setting that gave rise to the letter of payment is of paramount importance for understanding its functions and hence its development as an instrument that also facilitated non-cash payments between two places.

Third, strictly speaking, and as indicated, there is no doubt that the bill of payment involved the extension of credit to the obligor, who had the use of the money between its 'deposit' with him in one place and repayment by him at another place. There has however been a controversy as to what extent credit extension was a conscious element in the transaction, that is, beyond its being incidental to the time it takes to transmit the payment from place to place.

Thus, it was once thought that in the typical scenario, the letter or bill of payment was for the payment of a debt owed by the remitter/lender (located in one city) to the payee/receiver (located in another city). In this setting, the drawer and drawee were exchange bankers, respectively located in the place of the loan and the place of repayment. The drawee could thus have been an agent or a correspondent of the drawer.<sup>139</sup> In this case, the 'loan' given by the remitter/lender to the drawer/borrower is not a true extension of credit; rather, it is merely a device designed to render the drawee-exchange banker a debtor for the amount deposited in his hands by the drawer in order to carry out payment to the payee. Stated otherwise, in this setting the bill or letter of payment is a contract for the transportation of money and of *cambium* and no more. As a contract for the transportation of money it operates then very much like the Islamic *suftaj* discussed in chapter six above.<sup>140</sup>

This view on the typical setting for the original use of the bill or letter of payment de-emphasizes and in fact overlooks the credit function of the instrument

<sup>138</sup> Origo, above n 20 at 82.

<sup>139</sup> On this point, see Holdsworth above n 20 at 128–37, following Huvelin, 'Travaux', above n 37 at 5. See also CHS Fifoot, 'The Development of the Law of Negotiable Instruments and the Law of Trusts' (1938), 59 *Journal of the Institute of Bankers* 433, 434.

<sup>140</sup> Except that Islamic *suftaj* did not involve currency exchange. See ch 6, section 3.2 (as well as section 3.3).

and is not favoured anymore. This view possibly reflects a later period, in the course of the transformation of the bill of payment to the negotiable bill of exchange, as discussed below in section 5. Instead, the current thinking envisages a more sophisticated use of the original instrument. Rather than as a remittance facility for an inter-city payment from a debtor to a creditor, the original bill is viewed as a facilitator of trade-finance. As such, it was issued in connection with a borrower's obligation for the repayment in a foreign market of a loan that financed the purchase by the borrower, in his local market, of goods to be exported by him to that foreign market.

Under this second view, the drawer was typically a seller of goods who sent them for sale in a foreign market. Originally, such a foreign market was likely to be a fair. To finance his own procurement of the goods, the seller obtained a loan from a local exchange banker. In return for the money lent, the exchange banker received from the drawer-seller a letter of payment. Under that letter, the drawer-seller instructed a drawee, located in the foreign market to which the goods were to be shipped, to make payment to a payee located in that market. For his part, the exchange banker acted as a remitter; having delivered the money to the drawer-borrower, he sent the letter of payment issued to him by the drawer to the payee.

The drawer-seller used the actual loan proceeds to buy the goods at his own place; subsequently, he shipped the goods to the foreign market. Having anticipated receipt of payment for the goods in the foreign market, in his loan agreement with the exchange banker, the seller undertook the repayment of the borrowed money in the foreign market.<sup>141</sup> As for currency, as explained below, the bill was stated to be payable in a territorial unit of account of one of the cities, rather than in the actual money of payment.

In this setting, the seller drew the bill or letter of payment on the person who was to sell them on a retail basis in the foreign market, such as a fair. In the letter, the drawer-seller instructed the drawee to pay. Where the drawer-seller knew the identity of his own foreign buyer in advance, prior to the procurement or at least shipment of the goods, the drawee, whom drawer-seller, instructed to pay, could be the buyer. Such would be the case for example where the drawer-seller was a wholesaler in one city who sold the goods to a foreign wholesaler or retailer (in another city) who was to resell the goods in the foreign market, in which case, the foreign buyer could act as the drawee.

However, in most cases, the identity of the buyers was not known in advance; that is, the sale at the foreign market was to be carried out not by a buyer from the drawer-seller, but rather by the drawer-seller's own agent, principal, partner, or correspondent. Under such circumstances, the drawee, instructed by the drawer-seller to pay the payee, was the drawer-seller's agent, partner, or correspondent in the foreign market; he was to be paid by the buyers of the good shipped by the

<sup>141</sup> See eg De Roover, *Lettre de Change*, above n 42 at 29–31 and 43–45.

drawer-seller, and use the money received from them for the repayment of the loan originally taken by the drawer-seller from the exchange banker.<sup>141.1</sup>

Similarly, the designated payee was an agent, principal, partner, or correspondent of the lender in the foreign market. Upon receiving the letter, the designated payee would present it to the drawee for acceptance, and in due course, upon maturity, for payment. The bill was most likely drawn payable at maturity set by reference to the applicable *usance*,<sup>142</sup> so as to target maturity to coincide with the availability of the proceeds from the sale. By reference to the money (or more broadly, value) for which the bill was issued, the exchange banker-lender was the 'deliverer', the drawer-borrower was the 'taker', the drawee was the 'payer', and the lender's correspondent or agent was the 'payee'.<sup>143</sup> Presumably, any profit, that is, an amount realized from the sale, to the extent that it was higher than the sum repaid to the payee, and thus left in the hands of the drawee, acting for the seller-drawer, formed the drawee's commission, at least in part. Any balance, could either be reinvested, for example in the purchase of goods in the place of repayment, or repatriated to the seller-drawer's place, under the same mechanism. The sum paid to the payee could be repatriated to the remitter, with further profit, by having the payee lending it, against a new 'reverse' bill of payment given by a local borrower, namely an exporter in the payee's place, who was to ship goods for sale at the remitter's place. On that 'reverse' bill, the borrower-exporter would instruct a drawee at the remitter's place, such as his (the exporter's) own agent, to pay the remitter on the original bill. In the process, the remitter and payee on the original bill reversed their role, and respectively became the payee and the remitter on the 'reverse' one.<sup>144</sup>

It may be thought that the exchange transaction relieved participants from risks associated with counterfeit coins, to which they would have been exposed, had they been dealing with foreign currency with which they were unfamiliar.<sup>145</sup> This is however a misconception; generally speaking,<sup>146</sup> coins of the diverse currencies circulated throughout the entire Continent and, as a rule, merchants were familiar with them. Hence, the essence of the exchange was not a change designed to achieve payment in a particular currency as money of payment.

Rather, 'exchange by bills concerned moneys of account.'<sup>147</sup> In practice, bills of payment issued and payable in fairs indicated both units of accounts of the

<sup>141.1</sup> From the drawer-seller's perspective, the main difference between the two scenarios was that a drawee-buyer, but not a drawee-agent, was obligated to him for the value of the goods regardless of their actual sale. This however was a matter between the drawer and drawee that did not concern the remitter or the payee.

<sup>142</sup> For this term, see text around n 126 above.

<sup>143</sup> See eg Boyer-Xambeu et al, above n 99 at 30.

<sup>144</sup> JS Rogers, *The Early History of the Law of Bills and Notes: A Study of the Origins of Anglo-American Commercial Law* (Cambridge: Cambridge University Press, 1995) at 32–36.

<sup>145</sup> Cf Holdsworth, above n 20 at 128, speaking of the exchangers as coin experts.

<sup>146</sup> Though not without exceptions: Boyer-Xambeu et al, above n 99 at 77.

<sup>147</sup> Boyer-Xambeu et al, *ibid* at 70. 'The *money of account* is the currency in which an obligation is measured . . . The *money of payment* is the currency in which the obligation is to be discharged.'

‘present’ and ‘absent’ money.<sup>148</sup> They thus specified the amount paid by the remitter in the unit of account of one place (‘present money’) and the amount payable by the drawee in the unit of account of the other place (‘absent money’); at the same time, they did not specify money of payment by either party. Moreover, the territorial unit of account in which the bill was payable, that is, the amount of ‘absent’ money, was not necessarily that of the place of payment by the drawee; rather, between each pair of cities, ‘the sum for which the bill was a payment order was always drawn in the exchange money of only one of the cities concerned, regardless of the direction of the remittance.’<sup>149</sup> Stated otherwise, between the territorial units of accounts of each pair of cities, the identity of the one that served as ‘absent’ money, in which it was payable by the drawee, as well as of that serving as ‘present’ money in the place of issue to the remitter, was fixed, regardless of the direction of the remittance.

One such specimen is that of a bill from 1537, delivered in Lyons against payment worth 100 écus, to be paid in Seville in an amount equivalent to 37,800 maravedis.<sup>150</sup> Both the écu and the maravedi are moneys of account. In such a case, money may have been delivered in Lyons in Florentine gold and settled in Seville in venetian sequins.<sup>151</sup> For each bill, the amount of money of payment, in the currency selected by each pair, namely remitter-drawer at place of origin, and drawee-payee at the destination, was set according to a locally determined method.<sup>152</sup>

*Woodhouse AC Israel Cocoa SA Ltd v Nigerian Produce Ltd* [1971] 2 Q.B. 23 at 54 per Lord Denning MR; italics in original. For money of account in the Middle ages, see P Spufford, ‘Appendix: Coinage and Currency’ in MM Postan, EE Rich and E Miller (eds), *The Cambridge Economic History of Europe*, vol III: Economic Organization and Policies in the Middle Ages (Cambridge: Cambridge University Press, 1965, reprint 1979) at 576, 593.

<sup>148</sup> For this terminology, see text around nn 121–23 above.

<sup>149</sup> Boyer-Xambeu et al, above n 99 at 83, who further notes (at 82 and 94) how this facilitated ‘the systematic enrichment of the exchange bankers’ through a ‘double exchange transaction’ which they explain at 82–91 and 94–100. Briefly stated, the mechanism was premised on the fact that in terms of the currency of the amount remitted (‘*pretium*’ or ‘moveable’), the amount in which the bill was drawn payable (‘*res*’ or ‘certain’) was lower in the place of origin than in the place of destination. Accordingly, eg (*ibid* at 84–85), a Florence remitter would deliver the equivalent of 64 écus (the ‘moveable’) per one marc (the ‘certain’) to the drawer who needs this sum in Florence and who would order the drawee (the drawer’s associate) in Lyons, under the original bill, to pay the marc equivalent, as specified in the bill (according to same rate of one marc equals 64 écus), to the payee in Lyons. The payee is associated with the remitter; he would be instructed by the remitter to deliver the sum received, under which a marc in Lyons is worth 65.5 écus, to a borrower in Lyons. Under a return bill, the Lyons borrower would order another person, associated with him, in Florence (and acting as a drawee on the return bill), to pay to the original Florence remitter an amount denominated in marcs, for which he paid in Lyons an equivalent denominated in écus, at the rate of 65.5 écus per marc. The original Florence remitter had thus lent at the rate of 64 écus per marc and received an amount with which he can purchase 65.5 écus per marc. His profit then is 1.5 écus. In this case, the marc and the écus are the relevant units of accounts. For both bills, namely the original (remitting funds from Florence to Lyons) and the return one (remitting funds from Lyons to Florence), the écus is the ‘present’ money while the marc is the ‘absent’ money.

<sup>150</sup> Reproduced in Boyer-Xambeu et al, above n 99 at 31. *Ibid* at 74.

<sup>151</sup> *Ibid* at 74.

<sup>152</sup> Regarding payment at the destination, Boyer-Xambeu et al, *ibid* at 94, note that after 1550 the Italians and the French disagreed on such methods. ‘The former tried to impose payment of

As a rule, a 'payment fair' (or central exchange fair), effectively being the Medieval money market, took place next to each merchandise fair.<sup>153</sup> Payment procedures were not static, they developed over time and were subject to local variations.<sup>154</sup> A developed payment procedure in the Fairs of Lyons in the fifteenth and sixteenth centuries consisted of three stages, each taking place on a different day.<sup>155</sup> These stages were acceptance (first day), exchange (third day), and settlement (sixth day). On the day of acceptance all participants would meet; payees would present bills payable in an amount denominated in the territorial money of the fair on respective drawees. In the next one or two days, participants drew up balances. A *conto*, namely a set of exchange rates, was determined on the day of exchange. These exchange rates were designed to apply to future transactions in the aftermath of the fair as well as to facilitate further exchanges at the fair itself until day of settlement, so as to allow participants to improve on their exchange balances. Finally, on the day of settlement, all transactions falling due in the fair were settled. Each participant would endeavour to pay his debts by either cancelling out mutual debts or by substituting his claim on another participant; a creditor who accepted this substitution of debtors did so at his own risk. Substitution was by delegation. Thus, where X owed Y who owed Z, Y would instruct X to pay Z. Execution of this delegation was 'perfect':<sup>156</sup> upon the agreement of both X and Z, Y was discharged. Unless X was in a position to cancel this debt by either offsetting it against a debt in the same amount owed to him by Z, or by replacing himself by means of a delegation to his own debtor, he would be in the same position as any debtor who was unable to cancel a debt. A debtor unable to pay a debt by cancellation or delegation would try to defer payment to the next (succeeding) fair for which he had to pay a fee. Debts that could not be settled in any of these ways had to be settled in specie, that is, in a specific currency, serving as money of payment.

This procedure is the forerunner of organized multilateral interbank clearing. However, its operation was premised on bilateral netting, except that it also allowed the substitution of debtors by agreement. More specifically, this was not a true multilateral clearing facility; rather, the procedure operated as a series of co-ordinated bilateral nettings in an organized multilateral setting, allowing the substitution of debtors so as to enhance savings in actual payments. At the same time, historically, this was the genesis of interbank clearing operating in an organized multilateral setting, rather than under an arrangement for individual banks to act in isolation and on an ad hoc basis.

two-thirds in gold coins, and succeeded in doing so in the middle of the century; the latter, who had no access to the exchange-banker's trade, later obtained the reinstatement of payment in gold or in "money" that was one-third "white" (silver) and two-thirds "black" (billon).'

<sup>153</sup> See Boyer-Xambeu et al, *ibid* at 70–91. See also De Roover, *Lettre de Change*, above n 42 at 74–82.

<sup>154</sup> See Usher, *Deposit Banking*, above n 8 at 110–33. See also Huvelin, *Essai*, above n 133 at 534–93.

<sup>155</sup> The ensuing discussion draws on Boyer-Xambeu et al, above n 99 at 91–94.

<sup>156</sup> For the perfect execution of the delegation under Roman law, see ch 5, section 6 above.

It is noteworthy that this mechanism was workable only in the context of functioning networks of merchants and bankers;<sup>157</sup> in fact, as indicated, in practice, the banking network was superadded to an existing mercantile network. Also, in this setting the bill or letter of payment was more than an instrument for the transportation of money and the conversion of currency, and in which the extension of credit was a mere incident of the transportation of money. Rather, in this setting, its use as a credit facility was a distinctive cardinal feature of the mechanism. Thus, the drawer was a 'true' borrower and the remitter was a 'true' lender. As for the nature of the loan under Medieval law and practice, the shipper-drawer-borrower was absolutely and strictly liable to repay the loan, or more specifically, the amount of the instrument, regardless of the safe arrival of the goods to their destination, and irrespective of whether their sale generated adequate proceeds. In this respect it was unlike the older 'sea loan' for whose repayment the borrower was not responsible in case of the loss of the goods.<sup>158</sup>

Stated otherwise, the drawer, shipper of goods to a foreign market such as a fair, used the facility to obtain a loan to be used for the acquisition of the goods and their shipment, which was intended to be repaid out of the proceeds of the subsequent sale of those goods in the foreign market. At the same time, this use of the instrument took place without hindering its employment in fulfilling its two other functions; that is, of the transportation of the money from the place of the loan to the place of its repayment, and the conversion of the money between two currencies.

Certainly, for such a mechanism to work, the drawer/exchange banker in the first setting (that of a straightforward remittance from place to place) and the remitter/lender in the second setting (that of a remittance to finance the export of goods)<sup>159</sup> envisaged some use, at the place and currency of payment, for the actual funds to be repaid at the place of payment. As indicated,<sup>160</sup> such use may have been a profitable contract for the repatriation of the funds. Alternatively, the drawer and drawee in the first setting, and the remitter and the payee in the second, were correspondents, with mutual dealings going back and forth in both directions.

In fact, due to limitations imposed by usury prohibitions and restrictions, the exchange mechanism was the only viable money market available throughout the Middle Ages. Hence, to borrow funds needed for their business, parties with neither foreign correspondent nor involvement in foreign trade resorted to the

<sup>157</sup> In the words of De Roover, 'The Organization of Trade', above n 10 at 43, 'How to get satisfactory representation in foreign parts was perhaps the major problem of [the] sedentary . . . merchant, and success or failure often depended on the selection of efficient and honest representatives.'

<sup>158</sup> For the various types of sea loans, see De Roover, *ibid* at 55–59. Huvelin, 'Travaux', above n 37 at 2 mentions the distinction alluded to in the text above by referring to the sea loan as '*prêt à la grosse*' in which the 'transporter', namely the borrower, does not assume operational risks. See also AE Sayous, 'Le Commerce de Marseille avec la Syrie au Milieu du XIII<sup>e</sup> Siècle' (1929), 95 *Revue des Études Historiques* 391 at 405–07 (hereafter: Sayous, 'Marseille avec la Syrie').

<sup>159</sup> For the two settings see text around nn 137–41 above.

<sup>160</sup> See text around nn 142–44 above.

dry exchange, already referred to above.<sup>161</sup> That mechanism worked as follows: a local business borrowed from a local lender (exchange banker) who had a correspondent or branch elsewhere. The intent was to repay at the currency and place of the loan, at a rate that would reflect an exchange rate between that currency to the currency of the place of the lender's branch or correspondent. However, a 'direct' implementation of this would have been a straightforward offence against usury laws. In order to circumvent the usury laws, an indirect design was put into place.

Under one variant of such design, the borrower drew a bill on a fictitious correspondent or branch allegedly located in another place. The bill was made payable in the 'absent' money to the lender's (existing) correspondent or branch in that place. As in connection with the legitimate exchange, having drawn the bill, the borrower gave it to the lender, who sent it to the payee. By nature of things, as there was no real drawee around, the bill was dishonoured, and the borrower-drawer, being liable to the lender,<sup>162</sup> was called to meet his obligation at the place of the loan.<sup>163</sup>

Under another variant, the borrower drew a bill on the lender's correspondent or branch, situated at another place. The bill was made payable in the 'absent' money to the drawee (namely, the lender's correspondent or branch) at the drawee's place. The lender sent the bill to the drawee who debited the borrower's account and credited that of the lender. After a couple of days the drawee cancelled both entries and drew a second bill on the borrower payable to the lender; he then sent the bill to the lender. That is, the original exchange transaction was replaced by a re-exchange. Upon receiving the bill, the lender presented it to the borrower for acceptance, and in due course for payment.<sup>164</sup>

Alternatively, under that second variant, the original bill was not even sent to its purported destination. '[T]he contracting parties did not even take the trouble to send bills abroad.' In such a case, the mechanism was called a fictitious exchange, which was 'merely a form of dry exchange' in which '[b]ills were simply made out *pro forma*, often under fictitious names.'<sup>165</sup>

Historically, the dry exchange was an attempt to disguise the true nature of the transaction with the view of bypassing usury laws, providing for limitations or prohibitions on the interest rate to be lawfully charged on a loan. Indeed, like the true exchange transaction, the dry exchange was speculative, since neither party could predict with certainty which way the exchange rate would swing. As such, it did not appear to be usurious. However, unlike the laxity it demonstrated towards the genuine currency exchange, doctrine 'frown[ed] upon dry

<sup>161</sup> See text around n 114 above.

<sup>162</sup> For the drawer's liability to the remitter under the bill of payment, see below, text at n 174 (under modern law) and text around nn 200–01 (under Medieval law).

<sup>163</sup> For this design, see J Marius, *Advice Concerning Bills of Exchange* (London: printed for Robert Horne, 1684) at 3.

<sup>164</sup> De Roover, 'Dry Exchange', above n 32 at 194–97.

<sup>165</sup> De Roover, *ibid* at 197–98 (both quotes).



exchange<sup>166</sup> and treated it as a loan; thus the transaction was suspect as usurious.<sup>167</sup> Moreover, the loan agreement may have required the borrower to repay a predetermined amount at the place of the loan, should he fail to repay at the other place. In such a case the transaction was certainly condemned by the church as a concealed regular loan, involving the illegal taking of interest.<sup>168</sup>

Regardless, the bill of payment was a flexible facility that could be used to fulfil various functions. The two functions already mentioned are (i) a remittance to a distant creditor and (ii) trade-finance, that is, the repayment of a loan for the purchase of goods with the proceeds of the sale of the goods in a foreign market. While as stated above, it is likely that the trade-finance function was predominant, it does not follow that the remittance facility did not exist at all. As well, as will be seen below in section 5, it seems that, as a general practice, the trade finance preceded the remittance scenario. In any event, in the remittance setting, the exchange banker acted as a 'borrower';<sup>169</sup> in the trade-finance scenario, he acted as a lender. Either way, the Medieval exchange banker neither accepted deposits – other than for transmission – nor lent money out of deposits; rather, he either 'borrowed' for transmission or lent out of his own capital for transmission. It follows that unlike Medieval transfer and deposit banking, discussed in section 2 above, Medieval exchange banking did not involve financial intermediation and unlike modern commercial banking did not thrive on the 'spread' between interest paid on deposits and received on loans. Rather, the Medieval exchange banker acted as money-transmitter; his profit flowed from the use of the money in the course of its transit (when it acted as a borrower) and from the exchange and hidden interest rates (when it acted as a lender).

To that end, the entire exchange banking enterprise could be profitable only in connection with large capitalization as well as an existing trade network. The latter was put to use for the extra task of transmission and receipt of funds lent or borrowed elsewhere rather than established specifically for the purpose of transmission. Medieval exchange banking was entirely different from modern commercial banking; likewise, it was not an authentic forerunner of present-day money transmission networks such as Western Union.<sup>170</sup> Indeed, the latter networks rely on retailers as the points of transmission and receipt of funds. As well, these networks may be involved in a change between money of remittance and money of payment. At the same time, they are not engaged in the transmittal of funds as an incident of a credit operation, and their exchange

<sup>166</sup> De Roover, 'Cambium ad Venetias', above n 113 at 239.

<sup>167</sup> De Roover, *Lettre de Change*, above n 42 at 19–21.

<sup>168</sup> See eg De Roover, 'New Interpretations', above n 3 at 203.

<sup>169</sup> This does not preclude the possibility of lending the funds for transmission, which would then be a separate transaction under which the remitter-payer will have to pay the drawer separately in the place and currency of the loan.

<sup>170</sup> For present-day money transmission networks see Committee on Payment and Settlement Systems (CPSS), World Bank, *General Principles for International Remittance Services* (Basel: Bank for International Settlements and World Bank, January 2007).

operations are more akin to money-change activities, albeit in conjunction with the transmittal of converted sums.

More generally, Medieval exchange banking was not a retail operation; other than in the dry exchange, a merchant participating in the transaction ought also to act on an international scale. Thus, as a 'lender' to the drawer-banker in the first scenario (that of a straightforward remittance from place to place), the merchant must have dealt with a foreign creditor, while as a borrower from the remitter-banker in the second scenario (that of a remittance to finance the export of goods), the merchant must have been a shipper of goods to a foreign market where he either must have dealt with a buyer or, more likely, had a representative. In short, if international trade is to be identified with 'big business', Medieval exchange banking was primarily 'big business' serving 'big business'.

However, as an adaptation of the function of remittance to a distant creditor, the bill of payment could be utilized also on a smaller scale, for what we call today a traveller's letter of credit.<sup>171</sup> For example, the remitter may be a traveller, student or pilgrim who gave funds to the drawer, an exchange banker at the place of departure in the currency of that place, with the view of receiving their equivalent at the place of the destination in the currency of that place. Such payment was to be received by the remitter/payee from the agent, principal, partner, or correspondent of the drawer, acting as a drawee. In such a case, the payee was the remitter; however, this particular use could also become a four-party facility, where a remitter forwards funds to a relative in the point of destination. Moreover, the letter of credit was not limited to personal affairs of individuals. Rather, as for example at the times of the crusades, 'Popes, kings and princes' extensively used letters of credit instructing payments in far away lands.<sup>172</sup> Such letters may invariably have been four-party facilities.

In fact, any bill of payment could be a two, three, or four-party facility. Stated otherwise, in each case, the drawer and the payee, and/or the remitter and the payee, could be the same person. As a mere machinery for the transmission of funds from place to place it could even be comprised of four units of the same legal entity. However, with the view of presenting a complete picture, the ensuing legal analysis supposes the involvement of four participants, viz a remitter (or deliverer; lender), drawer (or taker; borrower), drawee (who may become an acceptor upon agreeing to pay), and payee. I will now endeavour to analyse the legal relations between each pair of parties to the bill or letter of payment. To the extent possible, the discussion will be neutral as to the actual use of the facility. At the same time, where it matters, two alternative scenarios will be identified. The first is the remittance setting, under which the bill is used to pay a distant creditor. The second is the more predominant trade-finance setting, under which the bill is used in connection with a loan for the purchase of goods

<sup>171</sup> See eg De Roover, *Lettre de Change*, above n 42 at 44. *Ibid* at 90, he describes the letter of credit and bill of exchange as twin documents, with the former usually issued in favour of a non-merchant and payable against a discharge note ('quittance').

<sup>172</sup> See eg Usher, 'Origin', above n 103 at 569.

to be repaid in the foreign market in the currency of that market where the goods are to be sold.

#### 4. THE BILL OF PAYMENT: LEGAL RELATIONSHIPS

Under modern law, a remitter in possession of a bill of exchange may sue parties liable on it. Typically, this is on the basis of his ownership of the instrument<sup>173</sup> rather than any specific statutory provision.<sup>174</sup> Otherwise, under modern negotiable instruments legislation, liability on a dishonoured bill of exchange inures to the benefit of the holder.<sup>175</sup> The holder is either the bearer of an instrument payable to the bearer, or the named payee or endorsee of a bill payable to order while he is in possession of it.<sup>176</sup>

The general rule is that a signature is an absolute requirement for liability on a bill of exchange.<sup>177</sup> One exception is under French law, which allows the holder to recover from the drawee, on the basis of *la provision*, that is, what the drawee owes the drawer, even without an acceptance.<sup>178</sup> Otherwise, a drawee incurs liability only by signing as an acceptor.<sup>179</sup> Regardless, where the drawee declines to honour the bill, the holder may sue him where he is liable; the holder always has the option of suing the drawer as well as any endorser.<sup>180</sup> A drawer who pays the holder has recourse against the acceptor.<sup>181</sup>

<sup>173</sup> For the remitter as the first owner of an instrument, see FK Beutel, 'Rights of Remitters and Other Owners not within the Tenor of Negotiable Instruments' (1928), 12 *Minnesota Law Review* 584; and WE Britton, *Handbook on the Law of Bills and Notes*, 2nd edn (St. Paul, Minn: West, 1961) at 179. See also B Geva, 'The Autonomy of the Banker's Obligation on Bank Drafts and Certified Cheques' (1994), 73 *Canadian Bar Review* 21 at 30–34.

<sup>174</sup> An exception is U.C.C. Article 3, above n 91, under which a remitter (defined in §3-103(a)(15), while in possession of the instrument, is said by Official Comment to §3-301 to be a nonholder in possession, who under §3-301(i) 'has the rights of a holder' so as to be entitled to enforce the instrument issued to him.

<sup>175</sup> BEA s 38(1); cf Geneva Bills Convention arts 16–19 and 40; U.C.C. §3-301(i); UNCITRAL Bills Convention arts 27, 70, and 77. For the full citation of each of the four sources, see n 91 above.

<sup>176</sup> BEA s 2; Geneva Bills Convention art 16; U.C.C. §1-201(b)(21)(A); UNCITRAL Bills Convention arts 5(f) and 15. For the citation of each of the four sources, see *ibid*.

<sup>177</sup> BEA s 23; Geneva Bills Convention arts 7–8; U.C.C. §3-401; UNCITRAL Bills Convention art 33. For the citation of each of the four sources, see *ibid*.

<sup>178</sup> For *la provision* in French law, see eg C Gavalda and J Stoufflet, *Instruments de Paiement et de Crédit*, 7th edn edited by J Stoufflet (Paris: LexisNexis, 2009) at 105–14; and for a summary, P Ellinger, 'Negotiable Instruments' in JS Ziegel (chief ed), *Commercial Transactions and Institutions*, vol IX of U Drobnig and K Zweigert (responsible eds), *International Encyclopedia of Comparative Law* (Tübingen: JCB Mohr, 2000) at 110–13. See also G Ripert and R Roblot, *Traité de Droit Commercial*, 13th edn (Paris: Librairie Générale de Droit et de Jurisprudence, 1992) at 181–86. For a more extensive analysis see P Lescot and R Roblot, *Les Effets de Commerce* (Paris: Rousseau, 1953) vol I at 389–465.

<sup>179</sup> BEA s 53; U.C.C. §3-408; UNCITRAL Bills Convention arts 37, 40. Cf Geneva Bills Convention arts 21, 25, and 28. For the citation of each of the four sources, see n 91 above.

<sup>180</sup> In principle, a cause of action against the drawer and endorsers is available to the holder upon compliance with formalities, such as presentment to and dishonour by the drawee, and notice given to parties to be held liable. See BEA s 55; Geneva Bills Convention arts 9, 15, and 43–45; U.C.C. §§3-414, -415, and art 3 Part 5 (Dishonor); UNCITRAL Bills Convention arts 38, 44. For the citation of each of the four sources, see *ibid*.

<sup>181</sup> Particularly, see BEA, above n 91, s 59(2)(a).

A remitter does not sign the bill; as such he is not liable on it. Whether he can be sued on the transaction for which the bill was given once the bill reached the payee, depends first on whether the bill was issued to the payee in payment of a debt owed by the remitter to the payee. Second, it depends on whether the payee had taken the bill of exchange in conditional or absolute discharge of the debt owed to him by the remitter. Only in the former case, that of a bill taken in conditional payment, is recourse on the underlying transaction available to the holder against the remitter.<sup>182</sup>

In principle, as will be set out at the beginning of section 5 below, the Medieval bill of payment was not transferable; hence, the only party corresponding to the modern 'holder' was the payee. In this context, I will now attempt to trace the foundations of the rules set out above in the Medieval application of principles derived from Roman law. To that end, general relevant principles, fully discussed above in chapter five, are to be reviewed.

Briefly restated, Roman law dealt with the delegation order given by debtor, to his own debtor (paymaster) to pay to the debtor's creditor. Upon receiving the delegation order, the paymaster does not automatically become obliged to pay the creditor. Nor does the paymaster's agreement to comply with the instruction necessarily discharge the debtor's debt to the creditor. Rather, it is payment by the paymaster which discharges both his own debt to the debtor and the debtor's debt to the creditor. Accordingly, a paymaster who declines to follow the delegation order remains indebted to the debtor who remains indebted to the creditor.<sup>183</sup>

At the same time, execution of the payment order by means of the paymaster's agreement is fully recognized; Roman law facilitates both the imperfect and perfect execution of the debtor's delegation order, instructing the paymaster to pay the debtor's debt to the creditor.<sup>184</sup> As pointed out below, such execution may or may not discharge the debtor's debt to the creditor.

Furthermore, Roman law facilitates the issue of a delegation order by a paymaster to his correspondent acting as his own paymaster.<sup>185</sup> Such 'sub-delegation' may have been the model for the Islamic *suftaj*, under which, in connection with the transfer of funds from one place to another, a paymaster in the point of origin instructed a correspondent at the point of destination to make the payment.<sup>186</sup> Under some circumstances a sub-delegation may also explain the legal effect of the letter of payment.

Thus, in our setting, in circumstances under which the letter of payment is a mechanism for the payment of a debt owed by the remitter to the payee, the letter corresponds to the sub-delegation of the remitter's delegation order to the

<sup>182</sup> The distinction is codified in U.C.C. art. 3, above n 91, at §3-310. A good common law discussion is *In re Charge Card Services Ltd* [1988] 3 All E.R. 702 at 707 (C.A.).

<sup>183</sup> See in general, ch 5, section 3 above.

<sup>184</sup> See in general ch 5, section 4 above.

<sup>185</sup> See in general ch 5, section 10.3 above.

<sup>186</sup> The *suftaj* is fully discussed in ch 6, section 3 above.

drawer. In this context, the remitter is the first delegant, instructing the taker-borrower to pay to the payee; in turn, the taker-borrower, being in effect the paymaster/drawee in the first transaction, upon the sub-delegation, becomes the delegant/drawer of the letter of payment instructing the drawee under the letter of payment to pay to the payee.

The distinction between the imperfect and perfect execution of the delegation order is expressed in the effect of the acceptance by the drawee, upon which he becomes liable to the payee, on the obligation of the debtor to the creditor. Thus, upon an imperfect execution, the order-giver, that is, the debtor, remains liable to the payee-creditor even after acceptance by the order-recipient, viz, the drawee. Conversely, in the perfect execution of the delegation order, the acceptance by the drawee discharges altogether the debtor. The two classic means for the imperfect execution are the *receptum* and *constitutum*. At the same time, the novation by stipulation<sup>187</sup> is the classic mode for the perfect execution.

*Receptum argentarii*<sup>188</sup> is limited to the case of a promise undertaken by a banker (*argentarius*), acting under the instruction of his client, to perform towards a third party, on a fixed date. The banker's obligation is entirely autonomous, namely, free of defences that may have been available to the client against the third party, and enforceable by the third party against the banker even when the client's obligation to the third party was invalid.<sup>189</sup> At the same time, the banker's undertaking to the third party does not impact the client's own original obligation to the third party; that is, until satisfaction, both obligations to the third party, that of the client and his banker, subsist side by side, and are enforceable by the third party.

The *constitutum* is a promise to pay an existing debt on a stated date and at a stated place. The existing debt is either that of the promisor or of another party. The former is a case of *constitutum proprii* and the latter is that of *constitutum debiti alieni*.<sup>190</sup> The promise given under the *constitutum* is that of an assurance as to the availability to the creditor on due date of the sum owed under the original debt. No formal requirements are to be met by the promise in order to be binding; it could be given orally, in writing, *in absentia*, and even by messages; most frequently, it was given by means of a letter sent (rather than

<sup>187</sup> The *receptum* and *constitutum* are fully discussed in ch 5, section 5 above. Novation by stipulation is fully discussed in ch 5, section 6 above.

<sup>188</sup> For a comprehensive discussion, see G Platon, *Les Banquiers dans la Législation de Justinien* (Première Partie) (Paris: Librairie Recueil Sirey, 1912) at 43, Chapitre II: Le 'Receptum argentarii', as well as subsequent chapters, dealing with the relationship between the *receptum argentarii* and various other legal obligations.

<sup>189</sup> Or else, as put by Platon, *ibid* at 46, the *receptum* does not require any 'causa'; it thus stands on its own absolute or abstract terms.

<sup>190</sup> See Berger, above n 109 at 410; H Coulon, *Droit Romain: Du Constitut Debiti Alieni* (Poitiers: Typographie Oudin, 1889); A Philippin, *Le Pacte de Constitue – Actio de Pecunia Constituta* (Paris: Duchemin, 1929); and J Déjardin, *L'Action Pecuniae Constitutae* (Paris: Rousseau, 1914). See also Platon, *ibid* at 164, Chapitre V bis, 'Histoire et Rôle du Constitut'; and E Guillard, *Les Banquiers Athéniens et Romaines – Suivis du Pacte de Constitut en Droit Romain* (Paris, Lyon: Guillaumin, H Georg, 1875) at 104-30.

directly delivered) by the promisor.<sup>191</sup> The rationale underlying the *constitutum* promise is that of modification to the promise to pay an existing debt, by an additional promise simultaneously given at the time the loan is extended.

Like the banker's promise on *receptum argentarii*, the *constitutum* promise does not lead to the novation of the pre-existing debt and does not supersede it; it gives the creditor the option of an alternative remedy. Contrary to the stipulation discussed further below, the *constitutum* promise is given at the initiative of the party to become liable on it, and not in response to a creditor's question; as such, and contrary to the *receptum argentarii*, the *constitutum* promise is not presumed to be autonomous and free of defences arising from the pre-existing debt, including as to its validity. However, both the lack of a novatory effect and autonomy may have been based on the intention of the parties, and hence are more certain to exist in *constitutum proprii* than in *constitutum debiti alieni*; the latter may nevertheless be taken to be intended to both discharge the original debtor, so as to have a novatory effect, and to be autonomous in relation to the original debtor's pre-existing debt.<sup>192</sup> And yet, in the absence of novation, it is not all that obvious what legal doctrine could implement such intent.

A most frequently used route for a perfect execution of the delegation is *stipulatio*.<sup>193</sup> Contrary to both the *receptum* and *constitutum*, the *stipulatio* serves as a mode for the perfect execution of the delegation order. It is an oral solemn contract concluded in the form of a face-to-face exchange of a question and an answer between two persons who, on the basis of the successful completion of the exchange, become parties to a contract. It is a formal, verbal, unilateral, and *stricti juris* contract;<sup>194</sup> its formation requires a question to be asked by the stipulant, a would-be promisee-creditor, immediately followed by an affirmative answer given by the person to whom the question was directed, who thereby becomes the promisor-debtor. The two parties must be in the presence of each other and the question and answer must be spoken; furthermore, 'there should be precise correspondence between question and answer.'<sup>195</sup> Typically, in our setting, the drawee's agreement to abide by the drawer's order by means of

<sup>191</sup> A point highlighted by Platon, *ibid* at 191, who calls such a mode of communication by letter *l'epistola*, and notes the similarity of the letter to the subsequent bill of exchange. According to Berger, above n 109 at 454, *epistula* is a private letter that becomes the property of the addressee upon receipt; 'Certain agreements, primarily consensual contracts . . . might be concluded by letter (*per epistulam*).'

<sup>192</sup> On this point see particularly Philippin, above n 190 at 88–93, where the Praetorian basis of the *constitutum* is cited as the justification for reliance on the parties' intention. For the role of the intention of the parties, see also E Bodin, 'Des Effets du Pacte de Constitut' (1866), 12 *Revue Historique de Droit Français et Étranger* 209. For a detailed analysis as to whether particularly the *constitutum debiti alieni* is to be taken as substituting the debtor, adding a co-debtor, or giving rise to a guarantee see Déjardin, above n 190 at 67–98.

<sup>193</sup> See definition in Berger, above n 109 at 716; and an analysis eg Lee, above n 109 at 298–304; and B Nicholas, *An Introduction to Roman Law* (Oxford: Clarendon Press, 1962) at 193–96.

<sup>194</sup> For classification of contracts, see concluding paragraphs of ch 5, section 1 above.

<sup>195</sup> Lee, above n 109 at 298. See also Nicholas, above n 193 at 193. Berger, above n 109, states at 716, v. 'Stipulatio', that '[t]he answer had to agree perfectly with the question; any difference or restriction (addition of a condition) made the *stipulatio* void.'

incurring a stipulatory obligation to the payee discharges the original obligation of the drawer to the payee and is autonomous with respect to it, namely, free of defences that may be available to the drawer against the payee.

Finally, there is the alternative of *cessio*.<sup>196</sup> In this context, a debt owed by the drawee to the drawer is transferred by the drawer to the payee. The payee, as an assignee, is to enforce against the drawee the debt owed by the drawee to the drawer, and as such is subject to defences available to the drawee against the drawer.

Indeed, as set out above in chapter five, section 10.3, Roman law could facilitate the payment to a distant party; as such it was capable of producing a mechanism similar in function to the letter of payment. However, in Roman law there is no role for the written document. As well, the classic *stipulatio* is unable to support a contract between two distant parties. Moreover, as set out in chapter five, section 8 above, already in the course of the first millennium CE, key concepts such as the *stipulatio*, *receptum*, and *constitutum* ceased to exist as avenues for recovery. Also, as further discussed in chapter five, section 9, notwithstanding Roman law's recognition of *cessio* in the sixth century CE, strong doubts as to its effectiveness to transfer rights persisted in civilian legal systems drawn on the Romanist tradition until the middle of the nineteenth century. It is against this background that the possibility of direct derivation of the bill of exchange from Roman law is forcefully denied by Holdsworth. In his view, 'it is clear that there is nothing in Roman law which in any way resembles the bill of exchange.' Indeed, he acknowledges, '[n]o doubt the *adstipulatio*, the *delegatio*, and the *novatio* could be made to fulfil some of the functions fulfilled by the bill of exchange; but we cannot find in the classical texts any institution which resembles it in form, or in mode of operation.'<sup>197</sup>

Nevertheless, the ensuing analysis will demonstrate the manner in which the adaptation of principles derived from Roman law underlay the legal relations among participants in the bill of payment transaction. In fact, this is acknowledged by Holdsworth.<sup>198</sup> Stated otherwise, Medieval lawyers used terminology derived from Roman law either by analogy, or by varying its contents.

Thus, among the four parties to the letter of payment transaction, direct privity exists between the remitter and drawer, the drawer and the drawee, and the remitter and the payee. In this setting, the remitter delivers the money to the drawer for the delivery of an equivalent sum of money denominated in another currency to the payee. The drawer and drawee are correspondents, if not a principal and agent,<sup>199</sup> though in theory at least, in the trade-finance setting, they may be a debtor and creditor, as for example, where the drawee bought the

<sup>196</sup> Fully discussed in ch 5, section 9 above.

<sup>197</sup> Holdsworth, above n 20 at 132–33.

<sup>198</sup> *Ibid.*

<sup>199</sup> Where they are mere correspondents, namely, neither the same person nor a principal and agent, Huvelin, 'Travaux', above n 37 at 12–13 rationalizes their relationship as premised on a *commenda*, that is, a form of partnership, under which the drawer puts the drawee with funds in performance of joint business purpose, viz, their delivery to the payee.



goods from the drawer. Where they are mere correspondents, namely, neither the same person nor a principal and agent, their relationship may be rationalized as premised on a *commenda*, that is, a form of partnership, under which the drawer provides the drawee with funds in performance of joint business purpose, viz, the delivery of the funds to the payee. Regardless, in the remittance scenario the drawer and drawee act as fellow bankers. In the trade-finance setting they act as fellow merchants. In the remittance setting, the remitter and the payee may respectively be a debtor and creditor under a pre-existing transaction. Alternatively, in the more prevailing trade-finance setting, the remitter and payee act as bankers; they are either correspondents or a principal and agent.

The bill of exchange transaction is completed by the payment of the drawee to the payee. At that point, the drawer is discharged towards the remitter; the drawee is either discharged towards the drawer or becomes owed by him. In the remittance scenario, the remitter is discharged towards (his fellow merchant) the payee-creditor. Fellow-bankers, viz the drawer and the drawee in the remittance scenario and the remitter and payee in the trade-finance setting, are typically to settle periodically on bills going in both directions, possibly in a fair as outlined in section 3 above. For their part, the drawer and drawee act in the trade-finance setting as fellow-merchants; the drawer is to settle either for a single transaction, or again, for a balance reflecting a periodical activity, by means of another remittance, made from the place of the indebted party to that of the creditor.

The payee is not in privity with the drawer; he may nevertheless be in privity with the drawee-acceptor. At the same time, the remitter is in privity with the drawer but not with the drawee-acceptor. According to De Roover, under Medieval law, one participant may be liable only to another with whom he is in privity; thus, the drawer is solely liable to the remitter and the drawee may be liable only to the payee. Between these two beneficiaries, namely, the remitter and the payee, it is however the former and not the latter who is the 'master' of the bill.<sup>200</sup> Accordingly, as will be explained further below, though he is not in privity with the drawee, the remitter may revoke payment – namely instruct the drawee not to pay – even after acceptance by the drawee,<sup>201</sup> presumably any time until maturity. This would appear to pose a serious limitation on the payee's right against the acceptor, except that this subjection to the revocation power of the remitter fits very well with De Roover's view as to the position of the remitter as a banker-lender associated with the payee – rather than as a debtor of the payee.<sup>202</sup>

De Roover's analysis treats the bill of payment transaction as a mechanism for the execution of the exchange contract. Thus, there is an exchange contract to which the remitter and drawer are the parties. In turn, there is the letter of

<sup>200</sup> See Marius, above n 163 at 17.

<sup>201</sup> De Roover, *Lettre de Change*, above n 42 at 92–94. The remitter's right and power to countermand payment of the bill is further discussed in text and n 237 below.

<sup>202</sup> See text that follows n 140 above.

payment; though it is issued by the drawer, it is the drawee who may be liable to the payee thereon. Accordingly, though derived from the same transaction and yet effectively from two separate contracts in relation to it, the drawer's obligation and that of the drawee are 'two species of obligation' which are 'conceptually and practically distinct'.<sup>203</sup> Their only link is the mutual impact of their performance. Thus, payment by the drawee to the payee discharges not only the drawee towards the payee but also the drawer towards the remitter; similarly, payment by the drawer to the remitter discharges not only the drawer towards the remitter but also the drawee towards the payee.

De Roover's perspective of the legal relationships is thus unlike that of the modern law as outlined above. Nor does De Roover purport to derive explicit support for his position from principles of Roman law.<sup>204</sup> A most extensive analysis to the contrary, covering a range of views, as to the liability of the drawer and the drawee-acceptor towards the payee and the remitter, is that of Huvelin; the picture he depicts purports both to derive from Roman law and be consistent with modern law.<sup>205</sup>

Regarding the drawer, Huvelin raises a preliminary question as to the very existence of his liability on the bill of payment. Indeed, already in the course of the fourteenth century, it was recognized that having received money from the remitter to be repaid by the drawee to the payee elsewhere, the drawer of the letter of payment is liable to the remitter, the deliverer of money to him, on the basis of the transaction between them. That transaction was either *emptio-venditio*,<sup>206</sup> namely purchase and sale, or *permutatio*, namely barter.<sup>207</sup> However, this position had not been free from doubt.<sup>208</sup> In the absence of a signature expressed to be 'with recourse', the document does not contain any undertaking by the drawer; it is merely an instruction by the drawer directed to the drawee to pay to the payee. From this perspective, even the specific drawer's acknowledgement of issuing the instrument against 'value received' is not explicit enough to charge him with an obligation to pay. For these reasons, liability cannot be fastened on the drawer on the basis of the Roman law *constitute*, which requires an undertaking directed to a creditor to pay a pre-existing debt owed to him. Conversely, the bill of payment is a letter addressed to the drawee-paymaster, rather than to the payee-creditor, which does not contain any undertaking. By the same token, in the absence of an explicit engagement to that effect, the drawer cannot be taken to agree to become a guarantor.

<sup>203</sup> Rogers, above n 144 at 98. See also Usher, *Deposit Banking*, above n 8 at 88.

<sup>204</sup> But cf text around nn 241–42, below, for the reconstruction of De Roover's position according to principles derived from Roman law.

<sup>205</sup> Huvelin, 'Travaux', above n 37 at 4, 9–21.

<sup>206</sup> See eg De Roover, *Lettre de Change*, above n 42 at 207, summarizing the position of Baldo Degli Ubaldi (1327–1400).

<sup>207</sup> See text at and following n 109 above.

<sup>208</sup> For a brief discussion on the fourteenth-century debate on this point see eg Usher, 'Origin', above n 103 at 575.

Ultimately however, according to Huvelin, the drawer is to be made liable on the basis of the delivery of the letter by him to the remitter for further transmission to the payee. That is, while the letter is addressed by the drawer to the drawee, it is not sent by the drawer to the drawee but is rather given to the remitter who is to send it to the payee, for presentment to the drawee. According to Huvelin, this circuitous route to the final destination is not devoid of meaning; rather it shows a voluntary undertaking, an assumption of liability, by the sender towards the party to whom he sends the instrument.

However, it seems to me that Huvelin is not entirely clear as to whose benefit the drawer's liability inures on that basis. Thus, as long as the bill of payment is in the remitter's hands, liability is to run to the remitter. Conversely, once the bill of payment is in the payee's hands, liability may run in the payee's favour. Theory of the drawer's liability towards each one may differ and Huvelin is not sufficiently clear in explaining as to whom liability runs and on what theory. More specifically, having analysed the issue from the perspective of the drawer-remitter relationship,<sup>209</sup> he appears, in my view abruptly, to jump to the conclusion that the drawer is nevertheless liable both to (i) the remitter, on the basis of *constitutum*, as adjusted by mercantile usage; and (ii) the payee, as the destination party who is ultimately to receive the letter of payment, and present it to the drawee, to whom it is addressed.<sup>210</sup> Against this background, it is hard to tell whether the drawer's undertaking to the payee is autonomous and free from defences available to the drawer against the remitter. Also, the relationship between liability to the remitter and payee is not clear; does the drawer's liability to the payee replace or is it added to the drawer's liability to the remitter? Possibly, Huvelin may be taken to address a transformation in the identification of the party entitled to enforce the drawer's obligation,<sup>211</sup> and yet he is far from clear in setting out the process.

Alternatively, it is possible to understand Huvelin as saying that on the basis of the route of the letter, the drawer's liability thereunder is not towards the payee, but rather, towards its 'taker'<sup>212</sup> of the letter from him, namely, the remitter. In such a case, Huvelin's theory as to the original liability of the drawer to the payee, namely prior to acceptance by the drawee, must be taken to be premised on *cessio*. The transfer is by the remitter to the payee, of the remitter's right against the drawer; it is carried out by the delivery of the bill of payment to the payee. This would mean that the payee takes the bill of payment subject to all defences the drawer has against the remitter.<sup>213</sup>

<sup>209</sup> Huvelin, 'Travaux', above n 37 at 9–10.

<sup>210</sup> *Ibid* at 10–11. This is how Huvelin is understood by Holdsworth, above n 20 at 137, 139.

<sup>211</sup> As claimed by Usher, *Deposit Banking*, above n 8 at 89. This transformation is discussed in section 5 below.

<sup>212</sup> 'Preneur' in French is both payee and taker. This however is not a mere semantic. For the transition from 'taker' of money, viz the drawer, to 'taker' of the instrument, hence, the payee, as part of the transformation of the bill of payment to a negotiable bill of exchange, discussed below in section 5, see De Roover, *Lettre de Change*, above n 42 at 117.

<sup>213</sup> See ch 5, section 9 above.

The drawer is thus liable in connection with the issue of the bill of payment; at the same time, the presentment of the instrument by the payee to the drawee precipitates the latter's liability. Originally, the drawee was held liable upon the presentment of the instrument unless he had not protested. Subsequently, the drawee's liability became associated with a positive act on his part in response to the presentment, viz, the placing of a signature on the instrument, signifying an acceptance by him of the drawer's order to pay. Two issues arise. The first is the theory underlying the drawee-acceptor's liability. The second is the impact of the drawee-acceptor's liability on that of the drawer.

As for the first issue, two alternative approaches exist with regard to the drawee-acceptor's liability, each derived from Roman law. Thus, the view that ultimately prevailed in Germany is that the basis of this liability is that of a Literal contract, namely, a contract created on the basis of a special kind of writing. It is a formal contract, by definition *stricti juris*, namely, binding the promissor to the very thing he has promised, and hence unilateral; it may be referred to as abstract.<sup>214</sup> My own impression is that this contract could be either a variant of, or inspired by, the *stipulatio*.

At the same time, the alternative, and according to Huvelin the earlier, view that prevailed in France is premised on the theory of *la provision*, or 'the provision'.<sup>215</sup> As understood in French law in the late seventeenth century,<sup>216</sup> *la provision* is constituted by the sum of money held by the drawee for the drawer, or perhaps, more specifically, provided to the drawee by the drawer, with which the drawee is obligated to pay the bill. However, over the years, *la provision* acquired a more subtle and in fact broader meaning, having become the drawer's right towards the drawee, that may not necessarily be constituted only by a sum of money held by the latter to the former. *La provision* is thus distinguished from 'cover' or 'value'; 'cover' requires an actual asset, possibly a sum of money, and 'value' refers to what is, or to be, provided by the payee in return for the bill. On the other hand, *la provision* may be formed by an overdraft agreed by the drawee to provide the drawer. However, it appears that in its original meaning under French law, *la provision* was understood to give rise to either a debt or, effectively, a deposit,<sup>217</sup> though the latter term may have not been explicitly mentioned. The drawee's obligation arising from giving 'the provision' originally inures to the

<sup>214</sup> For all these types of contract, in the context of the classification of contracts under Roman law, see ch 5, section 1 above.

<sup>215</sup> See also Sayous, 'Méthodes Commerciales XV', above n 8 at 281.

<sup>216</sup> For the statutory reference in 1673, see eg JV Tardou, *La Provision de la Lettre de Change* (droit comparé – loi uniforme) (Paris, Laussane: Pichon, Roth, 1939) at 6.

<sup>217</sup> Cf the distinction in Jewish law between money owed on a loan and on deposit, discussed in ch 7, section 2 above. For an earlier meaning, used by Italian and German authors, denoting a commission charged in connection with the issue of a bill of exchange, see eg R Voegeli, *La Provision de la Lettre de Change et son Attribution au Porteur – Étude d'Histoire du Droit et de Droit Comparé* (Systèmes Français, Allemand et Suisse) (Paris: Librairie Générale de Droit et de Jurisprudence, 1947) at 7–12.

benefit of the drawer; entitlement passes to the payee when he takes the bill.<sup>218</sup> Its passage to the payee (and subsequently, to each subsequent endorsee), is either a matter of *cessio* or of 'sale of money'. To that end, the drawee's acceptance is viewed not as a new obligation, but rather, in the footsteps of the *constitutum*, as an acknowledgement, or confirmation, of an existing one, based on the receipt of 'the provision'.<sup>219</sup>

Under the *cessio* theory, the drawer transfers to the payee the debt owed to the drawer by the drawee. The drawee's acceptance serves the limited function of confirmation; as a matter of legal theory, it is not required to bind the drawee towards the payee.<sup>220</sup> At the same time, the 'sale of money' theory is premised, first, on viewing the manual money change transaction as a sale.<sup>221</sup> Second, it hinges on the analogy between the exchange and the manual change. The former is viewed as if the drawer physically gives the drawee coins, possibly, the same coins delivered to the drawer by the remitter, with the view of charging the drawee with the obligation to give their equivalent to the payee in the currency of payment. In this setting, the drawee's acceptance is the redirection of his agreement to abide by the instruction to the payee's benefit.

Huvelin prefers the 'sale of money' explanation<sup>222</sup> but acknowledges that ultimately in French law it is the *cessio* explanation which prevailed. Be that as it may, he points out a fundamental distinction between the French and German approach. Under the German approach, the acceptor's liability as a paymaster is based on his own undertaking to pay of a sum of money, and thus stands on its own; it is for the full amount of the instrument and is not subject to defences that may be available to him as a drawee against the drawer. In short, it is autonomous. Conversely, under the French system, what the acceptor owes to the payee is what, as a drawee, he received from the drawer. In other words, the acceptor is able to meet the payee's action by raising defences available to him as a drawee against the drawer. Stated otherwise, according to Huvelin, under the French system and in contrast to the German one, the acceptor's engagement to

<sup>218</sup> See cites in n 178 above. For the meanings of '*la provision*', 'value', and 'cover', see Lescot and Roblot, above n 178 at 390, 411–12. For the transfer of *la provision* as a 'sale' which defeats the drawer's creditors see eg H Levy-Bruhl, *Histoire de la Lettre de Change au France aux xviii<sup>e</sup> et xviii<sup>e</sup> Siècles*, (Paris: Recueil Sirey, 1933) at 91–95. In any event, drawer's creditors are to be defeated also under the *cessio* theory.

<sup>219</sup> For explaining the acceptor's liability as a confirmation of liability, and the procedural advantage accorded to his plaintiff suing on the acceptance in the Low Countries, see WDH Asser, 'Bills of Exchange and Agency in the 18th Century Law of Holland and Zeeland – Decisions of the Supreme Court of Holland and Zeeland' in V Piergiovanni (ed), *The Courts and the Developments of Commercial Law* (Berlin: Duncker & Humblot, 1987) at 103, 112.

<sup>220</sup> See ch 5, section 9 above.

<sup>221</sup> For this perspective, see text around nn 120–21, above. At the same time, and notwithstanding Huvelin, 'Travaux', above n 37 at 15–16, I do not see why a different result is produced if the 'sale of money' theory is replaced by barter.

<sup>222</sup> Particularly, see Huvelin, 'Travaux', *ibid* at 15, where he sees 'the provision' as an extension of the *commenda* (discussed in text that follows n 199 above), on which he rationalizes the drawer-drawee relationship.

the payee is not autonomous; rather, the acceptor's engagement to the payee is that of the drawee-acceptor towards the drawer.

Finally, there is the second issue arising in connection with the presentment to the drawee and the ensuing drawee's liability. This is the question of the payee's recourse against the drawer, either side by side with the payee's entitlement against the drawee-acceptor, or upon the default by the drawee-acceptor in dishonouring the instrument. In this scenario, the starting point is the fact that the drawer and payee are not in privity on the bill. It is against this background that De Roover adamantly states that in case of non-payment, sources are unambiguous in their denial to the payee of any recourse against the drawer, who under Medieval law is liable solely to the remitter.<sup>223</sup>

Conversely, Huvelin appears to assume the existence of the payee's recourse against the drawer though he may have glossed over its underlying theory;<sup>224</sup> as indicated, he may have explained the payee's right against the drawer as based either on *cessio*, or on the routing of the letter from the drawer, not directly to its addressee, the drawee, but rather, indirectly, to the payee via the remitter.<sup>225</sup> Regardless, Huvelin explains that neither the drawer's order nor the drawee's agreement to abide by it contains any release of the drawer's obligation to the payee. To that end, Huvelin unequivocally rejects the explanation of the drawee's acceptance as the execution of a delegation order in the form of novation by stipulation, as in his view this would have meant the release of the drawer.

Huvelin does not discuss the drawer's recourse against the drawee. Nor does he discuss the drawee-acceptor's liability to the remitter as well as the relationship between the remitter and payee. Presumably, being in contractual privity, relationships between the drawer and the drawee as well as between the remitter and payee are governed by respective underlying contracts. In other words, the drawee is likely to be liable to the drawer, from whom the payee or remitter recovered, on the basis of the *commenda* or '*provision*'.<sup>226</sup> By the same token, the unpaid payee may recover from the remitter if the latter owed the former and the bill of payment was not given in absolute discharge.<sup>227</sup> In turn, the drawee may be liable to the remitter, who has not issued the bill, on the basis of, that is, the transfer of, 'the provision', but not on the basis of the acceptance, which is the drawee's engagement towards the payee.<sup>228</sup>

The preceding discussion demonstrates that adaptation of principles derived from Roman law played a role in the search for an underlying theoretical basis for the bill of payment. Views set out by Huvelin differ both as to the identification as

<sup>223</sup> De Roover, *Lettre de Change*, above n 42 at 92–93.

<sup>224</sup> Huvelin, 'Travaux', above n 37 at 19–20.

<sup>225</sup> For his discussion as to whom the drawer is liable, see text in paragraphs containing nn 209–13 above.

<sup>226</sup> See n 222 above.

<sup>227</sup> Whether a bill is taken in conditional or absolute discharge is discussed in paragraph containing n 182 above.

<sup>228</sup> *Cessio* was discussed in connection with the payee's entitlement from the drawee as well as from the drawer. See text around nn 196 and 213 respectively above.

well as the extent of adaptation of relevant principles. Moreover, between De Roover and views canvassed by Huvelin, there appears to be a disagreement as to fundamental legal features of the instrument, particularly as to the payee's recourse against the drawer, and more generally, the relative position of parties in privity.

Each approach is in line with its proponent's view as to the prevalent use of the Medieval bill of payment. Thus, according to De Roover, the two primary parties to the bill of exchange transaction as relating to a genuine loan agreement are the remitter as lender and the drawer as borrower. In this context, the payee and the drawee are typically the respective agents of the remitter and the drawer. Hence, the primary relationship is between the remitter and the drawer. It is the remitter as lender who 'calls the shots'; therefore, the drawer-borrower is responsible only to him, and certainly not to the payee, who is a mere agent for the remitter.<sup>229</sup> Undoubtedly, it is only as the remitter's agent, and not on the basis of any right of his own, that the payee may sue the drawer, as well as the drawer's agent, viz, the drawee.<sup>230</sup>

At the same time, Huvelin appears to view the mechanism as primarily designed for the remittance of funds, that is, the transmission of a non-cash payment from a debtor (remitter) to his creditor (payee);<sup>231</sup> in this context, it is only logical to provide the payee-creditor with a direct cause of action against the drawee-paymaster, to whom the drawer-debtor delegated his payment obligation to the payee-creditor. It is thus the economic function and not the mechanical application of general principles of Roman law that underlies the disagreement as to fundamental legal features.

Seventeenth-century classic English authors discuss the matter along lines that unequivocally support De Roover's position as to the strict privity requirement. First, writing in 1622, Malynes discusses a somewhat complex bill of exchange transaction involving a chain of remitters,<sup>232</sup> as set out in more detail at the beginning of the next section of this chapter. In this context, Malynes is clear as to strict privity requirements. Thus, upon dishonour by the drawee, it is the drawer who has to pay. In turn, upon the drawer's own failure to pay, the drawer incurs liability exclusively to the remitter, who gave him the money.<sup>233</sup> Interestingly, in the context of this scenario, Malynes does not discuss – and in fact does not even mention – liability of, or even acceptance by, the drawee. However, elsewhere, Malynes mentions that according to 'the opinion of . . . Merchants', the payee may recover from the acceptor, notwithstanding the insolvency of the drawer.<sup>234</sup> This confirms both privity requirements and the

<sup>229</sup> De Roover, *Lettre de Change*, above n 42 at 92–94 and 115–17.

<sup>230</sup> For this position of the payee vis-a-vis the drawee in Holland and Zeeland during the eighteenth century, see Asser, above n 219 above.

<sup>231</sup> The two conflicting views as to the function and hence the operation of the mechanism are set out in text at nn 139–44 above.

<sup>232</sup> Malynes, above n 64 at 395–96.

<sup>233</sup> Malynes, *ibid* at 400.

<sup>234</sup> Malynes, *ibid* at 401.



acceptor's liability. At the same time, this absolute entitlement in the hands of the payee, irrespective of the drawer's insolvency, suggests that the drawee is liable other than as drawer's agent. Presumably this liability is based on the binding effect of the acceptance. Alternatively, however, the drawee's liability could be seen as derived from accountability for proceeds realized from the sale of the drawer's goods for whose procurement the drawer owes the payee's associate, namely, the remitter.

Second, writing in 1651,<sup>235</sup> namely, a quarter of a century later, Marius may be even more explicit. To begin with, he confirms the binding effect of the acceptance, even when given orally.<sup>236</sup> Next, however, he states that by delivering the money to the drawer, the remitter 'is rightly and properly Master' of the bill until it falls due; where he does not trust the payee anymore, the remitter 'can or may prohibit the [drawee who may have accepted the bill] not to pay' and redirect payment to be made elsewhere. Logically, he can undermine altogether the payee's right and collect from the drawer, thereby releasing the drawee-acceptor. The power, referred to as 'Countermand', is said to be premised on the fact that the payee is the remitter's agent.<sup>237</sup> Such is the case in connection with trade-finance bills and not remittance; thereby, Marius undoubtedly inspired De Roover, who nevertheless cites Malynes in support of that proposition.<sup>238</sup> In any event, it does not follow that the acceptor is liable to the remitter; rather, according to Marius, until satisfaction, the drawer is liable to the remitter, while the acceptor's liability inures to the benefit of the payee. In the footsteps of Malynes, Marius also treats the acceptor's liability as enforceable by the payee irrespective of the drawer's bankruptcy.<sup>239</sup>

Presumably, satisfaction is either by the drawer's payment to the remitter or the drawee's payment to the payee, so that effectively, payment by one releases the other. Only where the payee is an agent of the remitter, a typical situation according to De Roover,<sup>240</sup> both the drawer and drawee/acceptor are liable to the remitter;<sup>241</sup> and yet Marius does not even mention the possibility of the drawer becoming liable to the payee.<sup>242</sup>

<sup>235</sup> Marius first published his book *Advice Concerning Bills of Exchange* in 1651 (printed by IG), albeit in a shorter version. See Marius, above n 163 (Preface to the Reader). Unless otherwise indicated, all references in this chapter to Marius's book are to the 1684 edition, above n 163.

<sup>236</sup> Marius, *ibid* at 20 (irrevocability of acceptance) and 16 (verbal acceptance which may be constituted by a witnessed promise to accept) (respectively at 24 and 10 of the 1651 edition, *ibid*).

<sup>237</sup> Marius, *ibid* at 17–18 (at 16–17 of the 1651 edition, *ibid*).

<sup>238</sup> De Roover, *Lettre de Change*, above n 42 at 116–17 and fn 133. See also n 201 and text above. Certainly however, in envisaging transfer from one remitter to another, which involves replacements of payees, as set out in the following section, Malynes may truly be cited as an authority on the point.

<sup>239</sup> Marius, above n 163 at 20 (at 24 in the original 1651 edition, above n 235).

<sup>240</sup> See discussion in text around n 141 above.

<sup>241</sup> Marius, above n 163 at 26–27 (at 46–48 of the original 1651 edition, above n 235).

<sup>242</sup> An early case holding the drawer (effectively a paymaster for a buyer) liable to the payee (a seller) is *Chat and Edgar Case* (1663), 1 Keb. 636, 83 E.R. 1156 further discussed in ch 9, section 4 below.

This is certainly different from the position under modern law as well as from the picture described by Huvelin. Nevertheless, it does not follow that a doctrinal common denominator is not available. Thus, *the fundamental practical difference between Huvelin and De Roover is on the issue of the drawer's liability to the payee*. It is on the basis of an analysis of general principles derived from Roman law that Huvelin gives a positive answer.<sup>243</sup> For his part, De Roover does not cite Roman law principles; it does not follow, however, that they are necessarily contrary to his position. The following is an attempt to juxtapose both alternative views in a framework built on an expanded view of legal principles derived from Roman law.

Thus, in our setting, the remitter delivers money to the drawer and instructs him to repay its equivalent denominated in another currency to a payee located elsewhere. In return, the drawer delivers to the remitter the letter of payment in which the drawer instructs the drawee, located in the place of payment, to pay to the payee. The drawer sends the letter to the payee who presents it to the drawee first for acceptance and on due date for payment. The scenario thus involves two payment orders, one by the remitter addressed to the drawer, and the other, embodied in the letter of payment, is that of the drawer addressed to the drawee. They are to be analysed as follows:

- Where the remitter wishes to pay the payee in the discharge of a debt, the remitter's payment order is viewed by Huvelin as a delegation order. By executing it, the drawer becomes directly liable to the payee. Depending on the parties' intention and the mechanism chosen, execution may either be perfect or imperfect, with the remitter released in the former and remaining liable in the latter. For his part, Huvelin views the second payment order, namely that of the drawer to the drawee contained in the letter of payment, as an imperfect execution of the remitter's payment order so as to leave the remitter liable to the payee. Moreover, and this is particularly relevant when payment wished to be made by the remitter is not in the discharge of a debt owed by the remitter to the payee, the drawer may become liable to the payee even other than in the execution of a delegation order, either by forming a direct contract with the payee, or having his debt to the remitter transferred to the payee.
- At the same time, according to De Roover, the drawer's payment order is neither an execution of a delegation order, nor the basis for a direct contract with the payee; nor is there a *cessio* to the payee of the drawer's debt to the remitter. Rather, it is a simple mandate, pursuant to the drawer's agreement with the remitter, which does not affect the payee's relationship with the drawer as well as with the remitter.

Usher refers to what is effectively Huvelin's discussion as 'establishing the letter of payment as a type of the Roman agreement to discharge a debt.'<sup>244</sup> To a large

<sup>243</sup> See text at n 205 and thereafter above.

<sup>244</sup> Usher, *Deposit Banking*, above n 8 at 89.

extent, the preceding analysis demonstrates that De Roover's position could equally have been founded on the basis of principles derived from Roman law. In fact, as already argued in chapter five, section 11 above, the flexibility of such principles is a source of both strength and weakness; the strength is in the resilience of these principles to support the inclusion of both new and changing circumstances; the weakness is that as such, they can easily be manipulated, so that on their own, they lack predictability as to the ultimate result.

In the final analysis, on their face, De Roover's and Huvelin's conclusions are not reconcilable; this is however true only as long as we treat Huvelin's analysis as static, relating to the bill of payment in its pristine stage (as he understands it), rather than evolving around its transformation to the negotiable bill of exchange. Stated otherwise, De Roover's analysis appears to be correct for a bill of payment, prior to its transformation to the modern legal exchange; it is the instrument while being transformed which is in fact analysed by Huvelin. The process, discussed in the next section, is primarily characterized by the addition of an endorser to the cast of characters involved in the transaction. This took place in connection with changes to the use of the instrument, as well as with the imposition of stricter requirements as to its form. Unfortunately, Huvelin's analysis does not adequately address this aspect, momentous as it was for the transformation, and yet it is the legal relationship in the transformed bill which he appears to discuss.

##### 5. NEGOTIABILITY ACQUIRED: THE CONTINENTAL BILL OF EXCHANGE IN THE EARLY POST-MEDIEVAL ERA

The 'perfection' of the Medieval bill of payment into the modern bill of exchange required it to become a 'negotiable instrument'. The latter is a document of title to a sum of money, transferrable by delivery (either with or without an endorsement), and capable to confer title to it free of a third party's adverse claims and prior parties' defences.<sup>245</sup> The process of acquisition of negotiability by the bill of payment in the early post-Medieval era<sup>246</sup> is the topic of this section. The process evolved around the transferability of the bill, by a means of 'negotiation', facilitating its circulation. 'Negotiation' as a method of transfer became dependent on the form of the instrument, with a bill payable to the payee's order transferred or 'negotiated' by the endorsement and delivery of the holder, and the bill payable to the bearer transferred or 'negotiated' by delivery only.<sup>247</sup> Possibly, it is in the context of the process of acquiring 'negotiability', outlined in this section, that principles of Roman law, per Huvelin, as discussed in the previous section, may have been adapted to produce the foundations for the modern law of bills of exchange.

<sup>245</sup> See Cowen and Gering, above n 97 at 52.

<sup>246</sup> For the inclusion of this era within this chapter, see above, first paragraph of this chapter.

<sup>247</sup> For this conformity under modern law, see text at n 93 above.

The acquisition of 'endorsability' by the Medieval bill of payment so as to facilitate its transfer by 'negotiation' has been the key to the transformation to the modern bill of exchange. Indeed, there is no consensus as to the origin of the 'endorsement';<sup>248</sup> yet, functionally, it is clear that its introduction was the conclusion of a process aimed at the maximization of the use of the bill of payment as a payment mechanism. This was carried out by allowing the payee, and any subsequent holder, prior to maturity, to use the debt owed to him under the instrument as a means of payment to his own creditor. Thus, by facilitating the circulation of the bill of exchange, liquidity was enhanced in the marketplace. This turned the bill of exchange into a mechanism for deferred payment, under which, on maturity, the drawee was to pay against the presentment of the holder at the time; the latter was not necessarily the payee.

Endorsed bills can be traced to the early sixteenth century.<sup>249</sup> Nevertheless, it is evident that as a widespread practice the endorsement became known sometime in the second quarter of the seventeenth century.<sup>250</sup> Thus, endorsement is not mentioned by Malynes, who wrote in 1622,<sup>251</sup> but is discussed by Marius,<sup>252</sup> who wrote in 1651 and 1684.<sup>253</sup> A fully fledged banking practice premised on discounting endorsed bills of exchange has its origin in the course of the seventeenth century in England; it then spread to the Continent towards the end of the eighteenth century.<sup>254</sup>

One may only speculate as to the reasons for that hesitant and relatively late appearance of the endorsement. Thus, the standard Medieval bill of payment was drafted to state that it was payable to the payee for value received by the remitter.<sup>255</sup> As indicated in section 3 of this chapter, it was a mechanism for the execution of an exchange contract between two parties. According to De Roover, the payee, as an agent, principal, or correspondent of the remitter, was effectively his extension. In this context, the interference by a third party, such as an endorsee, unrelated to the remitter, did not fit the overall design of the transaction and thus was not envisaged.<sup>256</sup>

<sup>248</sup> See in general De Roover, *Lettre de Change*, above n 42 at 83–87.

<sup>249</sup> *Ibid* at 83 and 143. *Ibid* at 151, De Roover reproduces a bill from 1519, discovered in archives in Florence, which at 100 he identifies as possibly bearing the earliest endorsement.

<sup>250</sup> But *cf* reference to the rise of 'the practice of . . . transferring [bills] by indorsement . . . at the close of the sixteenth or the commencement of the seventeenth century' by Cockburn CJ in *Goodwin v Robarts* (1875) L.R. 10 Exch. 337 at 347.

<sup>251</sup> Malynes, above n 64.

<sup>252</sup> Marius, above n 163 at 6–9 (payee 'assigns', in effect, special endorsement), 30 (bill endorsed in blank) (at 53, only as to the latter, of the original 1651 edition, above n 235).

<sup>253</sup> See nn 163 and 235 above.

<sup>254</sup> De Roover, *Lettre de Change*, above n 42 at 143 with full discussion at 119–42. However, development may not be all that linear or subject to a consensus; thus De Vries and Van Der Woude, above n 70, quote at 136 an 'observer' who stated in 1701 that 'Amsterdam is the place where very nearly all the bills payable within Europe are drawn, remitted, or otherwise discounted and traded.' The authors note that it was only in the middle of the eighteenth century that 'London and Hamburg became important competitors to Amsterdam in the bills market.' *Ibid*.

<sup>255</sup> *Ibid* at 117.

<sup>256</sup> *Ibid* at 113, 115.

At the same time, circumstances arose in which the replacement of the designated payee was desired. To that end, a few Medieval imperfect mechanisms, none of which amounted to endorsement of a bill of payment, emerged. First, it was recognized that a sum of money due on an overdue instrument that had not been honoured could be transferred by means of a transfer order written on the instrument and signed by the payee.<sup>257</sup> De Roover reproduces a bill with three such transfer orders.<sup>258</sup> For his part, Malynes writes about two transfer mechanisms. One involves a bill of exchange<sup>259</sup> on which the payee's name is left blank.<sup>260</sup> The other is a mechanism for the transfer of bills of exchange prior to their making.<sup>261</sup> Finally, De Roover describes an elaborate procedure for a book transfer outside banks, which according to him is the forerunner of the endorsement.<sup>262</sup>

Among these, the first mechanism, that of the transfer of an amount owed on an overdue bill, is self-explanatory and does not require further elaboration. In contrast, the other mechanisms merit further discussion. Thus, as indicated, Malynes speaks of two separate mechanisms. The first is premised on a custom under which either a master sends to his servant, or one friend sends to another, in another city, 'Bills of Exchange, with the names in blank'. In each such case the payee's name is ultimately inserted by the receiver of the instrument signed in blank. Depending on 'the credit of him that made the Bill of Exchange', this is a mechanism that, according to Malynes, 'is accomplished very orderly'.<sup>263</sup>

Malynes' second technique is premised on 'an ordinary custom to transfer and put over . . . Bills of Exchange before they are made'.<sup>264</sup> Effectively, this is concerned with replacing the designated payee prior to the issue of the bill, on the basis of a chain of debts owed by one would be remitter to another. Stated otherwise, it is not the (as yet non-existent) bill which is transferred, but rather the entitlement to recover on it. Malynes gives the following example:<sup>265</sup>

Peter delivers five hundred pounds to John, who is to give the Bill of Exchange for it; Peter takes up five hundred pounds of William, and may give him the said Bill of John for it; William takes up five hundreds of Nicholas, and may deliver John's and Peter's Bill for it; Nicholas takes up five hundred pounds of Francis, and does give him the Bill of John, making mention of Peter and William.

<sup>257</sup> See eg Boyer-Xambeu et al, above n 99 at 32.

<sup>258</sup> De Roover, *Lettre de Change*, above n 42 at 153.

<sup>259</sup> Malynes uses the term 'bill of exchange' to refer to what is referred to in this chapter as a 'bill of payment'. As indicated, not only is the distinction far from clear, it is also not universally accepted and is used here to emphasize the distinction between the negotiable bill of exchange and its predecessor, the non-negotiable bill of payment.

<sup>260</sup> Malynes, above n 64 at 396–97 (under point 7).

<sup>261</sup> *Ibid* at 395–96 (under point 3), followed by analysis at 400 ('Twelfth observation').

<sup>262</sup> De Roover, *Lettre de Change*, above n 42 at 86–87.

<sup>263</sup> Malynes, above n 64 at 396–97 (under point 7). Here and in all subsequent quotes from Malynes, to facilitate smooth reading while retaining the flavour of the original language, modern spelling in each quotation is supplied by me in lieu of the archaic spelling in the original. As well, Malynes' italics denoting names are omitted.

<sup>264</sup> *Ibid* at 395 (under point 3).

<sup>265</sup> *Ibid* at 395–96 (under point 3).

In this example,<sup>266</sup> both Peter and John are in Antwerpen. Peter is the remitter who gives a sum of money to John with the view of receiving back a bill of exchange drawn by John and payable in London, presumably to Peter's associate. However, new transactions take place. Thus, sometime in the next two to three days,

- Peter takes money from William in Antwerpen<sup>267</sup> with the view of giving him a bill of exchange payable in London, presumably to William's associate.
- Subsequently, William receives the same sum of money from Nicholas in Antwerpen for transmission to London, presumably, to Nicholas' associate.
- Finally, Nicholas received the same sum of money from Francis in Antwerpen for transmission to London, this time to Francis' associate.

Malynes is unclear as to whether a bill of exchange was actually issued by John to Peter, and if so, whether the instrument is then physically given by Peter to William, by William to Nicholas, and by Nicholas to Francis. On one hand, he speaks of a chain of deliveries from Peter to William, onwards to Nicholas, and ultimately to Francis. This suggests the existence of physical paper. At the same time, Malynes indicates that John is 'to give' a bill, and more in general, speaks of bills transferred and put over 'before they are made', which suggests the constructive delivery of a bundle of rights embodied in a mere abstract and unissued bill. At the same time, Malynes is perfectly clear that ultimately, at the instruction of Peter (the original remitter),<sup>268</sup> a bill document is actually issued by John (the drawer throughout this chain of transactions). Once so issued, the bill is sent to Francis, effectively as the ultimate remitter, 'payable to his friend, factor or servant' located 'in the place for which the money was taken up', viz London:

To this Francis is the Bill of Exchange given, payable to his friend, factor, or servant in the place for which the money was taken up. But the said Bill is made by John the first taker up of the said money, declaring that the value of it was received of Peter for William and for Nicholas up on the account of Francis, which is the last deliverer of the money.<sup>269</sup>

Malynes analyses the ultimate situation as involving four debtors (or 'takers up of money' in his language), viz John, Peter, William, and Nicholas, each owing to the one that follows him in the list; the scenario further involves 'effectually one deliverer of money, which is Francis.' Accordingly, upon the payment of this

<sup>266</sup> Read in conjunction with an earlier paragraph, *ibid*.

<sup>267</sup> While Malynes (*ibid*) speaks of incurring debt by way of taking money by borrowing, the same analysis applies to indebtedness incurred otherwise, including by the purchase of goods on credit.

<sup>268</sup> Malynes speaks (*ibid* at 395) of the one in the position of Peter as causing that bill to be made. It is not clear, however, whether in addition to the consent of Nicholas, only the consent of Peter is required for the bill issued to Francis, or whether the consent of both Peter and William (in addition to that of Nicholas) is required for the issue of the bill to Francis. Malynes refers to each of the transaction as a 'bill of exchange' regardless of the fact that it is only the last one, that payable to Francis' associate, that materializes.

<sup>269</sup> Malynes, *ibid* at 396 (under point 3).

bill, 'all the parties in this Exchange are satisfied and paid'; that is, debts owed by John to Peter, by Peter to William, by William to Nicholas and Nicholas to Francis, are all discharged by this one payment, presumably by the drawee, to Francis' 'friend, factor, or servant'.<sup>270</sup>

Conversely, upon dishonour followed by non-payment by John, all debts subsist. In such a case, Francis is to pursue Nicholas who is to pursue William who is to pursue Peter who is to pursue John. No 'frog-leaping' appears to be allowed; that is, for each plaintiff, recovery is only from a party in privity with him, so that 'if Nicholas [is] broken, then all is lost'; that is, Francis may not recover from William, Peter, or John.<sup>271</sup>

The aforesaid legal analysis is fascinating; this is so if only because it bridges between the form of the document and the underlying substantive legal relationships in a way which is counter-intuitive to the modern legal mind. Thus, in terms of form, the bill as issued is drawn by John in Antwerpen on his London associate and payable to London Francis' associate; it is given by John to Francis (in Antwerpen), who is to send it to the payee. In this context, it is not surprising that payment by either the drawee in London to the designated payee, or upon dishonour, by John to Francis in Antwerpen, is a full discharge of all debts incurred in the transaction.<sup>272</sup> At the same time, upon non-payment, notwithstanding the form of the bill, and regardless of the fact that Malynes himself characterizes him as the ultimate sole 'deliverer of the money',<sup>273</sup> Francis has no direct recourse against the drawer John; nor is there any reference to a possible recourse by Francis against the London drawee. Rather, the 'true' remitter with a cause of action against the drawer John is Peter, despite the fact that ultimately he is classified as one of the four 'takers up of money'.<sup>274</sup> At the end of the day, what determined the position of each participant is not the formal appearance of the bill, but rather, the substantive contractual relationships leading to its issue.

Unfortunately, Malynes' text does not shed any light on the business context of the techniques he sets out. One may speculate that the first practice, that of a bill with the payee in blank, reflects a situation in which the remitter sends his goods to a foreign market with the view of selling them to an unknown wholesaler who may be interested in buying them;<sup>275</sup> he is aided by a representative in the foreign market whose task is to find such a buyer.

<sup>270</sup> *Ibid.*

<sup>271</sup> *Ibid* at 400 ('Twelfth observation'). It is however not specified in the text whether Nicholas' insolvency precludes William from recovering from Peter and Peter from John. Under principles of modern law the answer appears to be in the affirmative; as well, under such principles, Francis will not be precluded from recovering a dividend from Nicholas' trustee in bankruptcy and the latter from recovering the full amount from William.

<sup>272</sup> Certainly repayment by John to Francis in Antwerp will be in breach of the undertaking to repay in London. Malynes does not elaborate on possible liability for costs and incidental loss and who is to enforce recovery against whom.

<sup>273</sup> Malynes, above n 64 at 396 (under point 3).

<sup>274</sup> *Ibid.*

<sup>275</sup> A difficulty in this hypothesis is that it requires the remitter seller to know in advance the price to be paid by an unknown buyer in the foreign market.



The second technique, that of transfer of bills before they are made, is even more intriguing; it supposes a series of transactions in one market (Antwerpen in the example), each of which is to be repaid in another (London in the example). More specifically, this seems to be a series of transactions under which a loan to John is refinanced; it is originally extended by Peter, who then sells it to William, who, in turn, sells it to Nicholas, who finally sells it to Francis, who remains the ultimate holder of the loan. All this takes place in Antwerpen; the borrower John must be a shipper of goods from Antwerpen to London, who expects to have repayment made in London; he would not care to whom repayment is to be made as long as he is discharged from the debt on the loan he received from Peter. Peter, the lender, either sells the loan with profit, or has in mind an even better investment for which he needs funds to be obtained by selling the loan. The same applies to both William and Nicholas, one after the other. Or perhaps, all or some of the three, namely, Peter, William and Nicholas, advanced funds with no intention whatsoever to have a repayment in London; perhaps none of them even had a 'real' agent or correspondent there. Rather, each advanced funds with the view of selling the loan to a lender who truly requires repayment in London. Ultimately, Francis is such a lender; it is his agent who would be repaid in London.

Malynes observes that 'this is done with great facility',<sup>276</sup> which may not be surprising in light of the fact that all participants in the chain are merchants located in one place, viz Antwerpen.<sup>277</sup> As well, Malynes clearly lets us understand that the end result of the procedure is the settlement of 'more than one transaction' by means of one payment.<sup>278</sup> He thus provides us with a good description as to *how*, a good understanding to *what purpose*, but not much insight as to *why* it had been done.

Neither of the two practices, that of a bill with the payee in blank as well as that of transfer of bills before they are made, support De Roover's view as to the certainty in the names of the parties to the bill of exchange transaction, which according to him is the explanation for the lack of intervention by any third party, so as to preclude the emergence of 'endorsability'.<sup>279</sup> Perhaps this indicates that such practices were not all that widespread, and in any event, unlike in connection with endorsement, discussed further below, both practices required the co-operation of the remitter, without whom the practices could not work. Effectively, the second practice involved a series of transfers from one remitter to another of the loan asset rather than the transfer by the payees of the entitlement on the bill.<sup>280</sup>

<sup>276</sup> Malynes, above n 64 at 396 (under point 3).

<sup>277</sup> Certainly 'great facility' may be in the eyes of the beholder; I do not disagree with Holden, above n 93 at 40 who points out 'the obvious drawback to this procedure would be that it is hardly likely that [William] would know, before the bill was issued, to whom he would like to transfer it.'

<sup>278</sup> Holden, *ibid* at 39.

<sup>279</sup> See text around n 256 above.

<sup>280</sup> But *cf* Holden, above n 93 at 44, according to whom, had Malynes known of endorsement, 'he would not have found it necessary to describe the extremely cumbersome process of "putting over"

Regrettably, however, De Roover, who must have been familiar with Malynes' text, does not appear to address these practices, other than in referring to the passage dealing with the second practice as supporting his position as to two points. The first is that strict privity is required for an action to recover from a party liable on a bill of exchange. The second point is De Roover's identification of the remitter as the 'master' of the Medieval bill.<sup>281</sup> Thus, Malynes does not discuss the payee's cause of action; nor does he analyse the drawee's position, with or without an acceptance. In fact, the drawee and payees, being the London associates of the Antwerpen principal parties, are the only participants in the transaction to which Malynes does not even bother to give a name; indeed, the drawee and the early payees in the series are not even mentioned, and the ultimate payee is identified only as someone linked to Francis. Similarly, the drawee must be associated with John and each payee with a given remitter.

In a sense both points, that is, strict privity and the primary role of the remitter, are linked. Thus, as for the second point, that of the remitter as the 'master' of the bill, what is described as the transfer of a bill before it is created, is in fact a transfer from one remitter to another. It is thus the remitter who is the owner of the bill. At the same time, the first point was that of privity; to that end it is to be recalled that the ultimate payee, to whom payment is to be made, is the associate of the last remitter, that is, Francis in Malynes' example. However, it is only the first remitter, namely Peter, who can recover from the drawer John. Strict privity requirements are thus adhered to. In sum, each transfer led to the replacement of the payee, and yet the drawer remained liable only to the first remitter from whom he had received the money for transmission to London. The drawer's liability to the first remitter thus confirms both privity and ownership.

The final set of circumstances in which the replacement of the designated payee was desired and implemented in a Medieval imperfect mechanism<sup>282</sup> involved an elaborate procedure for a book transfer outside banks. According to De Roover this mechanism is the forerunner of the endorsement.<sup>283</sup> It was premised on the transfer of debts on books of merchants. Thus, a monetary debt payable on a future date, owed by one merchant to another, was recorded on the books of both merchants. The merchant-creditor could transfer such a debt to his own creditor by causing the proper entries to be posted to the books of the merchant-debtor. Thereby the merchant-creditor made payment owed by him to his creditor. In this setting, the merchant-debtor, on whose books the transfer is carried out, acts as a paymaster carrying out payment between a debtor (the paymaster's creditor) and a creditor. Ultimately, on the due date, one payment

bills before they were made: indorsements would have solved the difficulty.' For this to happen, the bills ought to have been made payable to the remitters themselves (in Antwerpen) rather than to their associates (in England).

<sup>281</sup> For both points according to De Roover, see text around n 200 above.

<sup>282</sup> The sets of circumstances are enumerated in the text of the paragraph containing nn 257–62 above.

<sup>283</sup> De Roover, *Lettre de Change*, above n 42 at 86–87. *Ibid* at 84–86 he discusses and rejects other theories.

in cash from the paymaster to the transferee discharged both the debt owed by the paymaster to the transferor and that of the transferor to the transferee. Of course, until such payment, the process could repeat itself, each time with a new transferee involved.

This method of payment was reminiscent of a book transfer on the books of a deposit banker;<sup>284</sup> in effect, it was conducted in the same way, with all three parties, namely, payer-transferor, his own debtor on whose books the transfer was carried out (acting as a paymaster), and the payee-transferee, attending together. Indeed, Medieval scholars characterized this facility as a non-banking or out-of-bank book-transfer.<sup>285</sup> It may also be referred to as a merchant book-transfer.

However, the similarity between the bank and merchant book-transfers ought not to be overstated. In some respects, a debt owed by a merchant is not the same as a debt owed by a deposit banker. True, a deposit banker is not necessarily more solvent than an established merchant. Nonetheless, one's random debtor's debtor may be less reliable or creditworthy than one's debtor, and certainly, unlike one's banker, had not been pre-selected. Furthermore, already in the Middle Ages deposit bankers were subject to some degree of public scrutiny and regulation.<sup>286</sup> Moreover, the theory under which payment on the books of a deposit banker may be treated by the payee as the equivalent of payment in cash, is premised on the assumption that the payee in any event would have deposited the cash received from the payer with the deposit banker, thereby making the deposit banker, in lieu of the payer, his creditor. Payment by bank book-transfer eliminates the cumbersome process of counting and assessing the quality of the coins received,<sup>287</sup> so that the book transfer on the deposit banker's books is in effect a short-cut to a bank deposit, bypassing altogether the cash payment of which it consists. It is against this background that a debtor paying by means of a bank book-debt is absolutely discharged, as if he handed the cash which was then deposited by the payee-creditor with the banker.

This cannot be said on a debt owed by a merchant. Hence, a creditor paid by means of a debt owed by a merchant, as opposed to a debt owed by a deposit banker, is not to be deemed as relinquishing his claim against the original debtor. Stated otherwise, grounds making the effect of the bank book-transfer to release the debtor altogether, do not exist in the case of a non-banking book-transfer. Had the law insisted on complete substitution, the procedure would have been less prevalent, and its practice would have been limited to circumstances where the replacing debtor (paymaster) had been pre-screened so as to be absolutely acceptable to the transferee/payee in lieu of the original debtor

<sup>284</sup> Bank book-transfers are discussed in section 2 above.

<sup>285</sup> See cites in n 42 above.

<sup>286</sup> For Venice, see eg Mueller, above n 34, particularly at 73–74 (licensing and bonding requirements) as well as 49, 52–53, 62–64, and 84–90. See paragraph that precedes the one containing n 37 above.

<sup>287</sup> For a fifteenth-century quote to a similar end see Mueller, *ibid* at 49.

(transferee). With this in mind, Medieval legal doctrine treated the non-banking transfer as carried out with recourse against the transferor/payer, to become available to the payee upon the default of the paymaster, the latter being the merchant on whose books the transfer was carried out.<sup>288</sup> Like the bank book-transfer, the non-bank book-transfer is a novation, and yet, subject to the reservation of recourse. *Quaere* as to whether the paymaster-merchant's obligation to the payee-creditor is autonomous, and if not, whether it is the obligation of the payer to the payee or that of the paymaster to the payee.<sup>289</sup>

Moreover, typically, a merchant book-transfer did not run as smoothly as that of the bank book-transfer. This is so since, compared to bank books, merchant books were less public and were not required to be easily accessible; that is, the Medieval deposit-banker was sitting physically in the marketplace with his books accessible for transactions to all customers. The books were scrutinized and thus were authoritative.<sup>290</sup> At the same time, as indicated, unlike banks, merchants were not supervised and their books were not subject to public scrutiny; hence, never mind legal requirements, transferor/payer and transferee/payee would not be prepared to have their presence bypassed in the process, and would insist on attending the posting of the transaction to the paymaster's books. This made the process cumbersome.

Merchant book-transfers differed from bank book-transfers in another respect. Thus, credit on a banker's books is available for use, including withdrawal, immediately; conversely, credit on a merchant's book is a mere deferral of a future payment, whether in cash, or by bank book-transfer. Hence, the two types of book transfers were not functionally equivalent; other than reducing the number of actual payments, there was no inherent advantage in the merchant book-transfer which did not provide the same payment finality or complete cash equivalency as the bank book-transfer. Nor was the particular advantage of reducing the number of payments obtainable universally only by means of a merchant book-transfer. Another alternative for the reduction of the number of payments, drawing on the merchant book-transfer, though limited to payees of bills of payment, had surfaced. Thus, like any other merchant, a payee of a bill of payment may have sought to use the debt owed to him on the bill to pay his own debt owed to another local merchant. However, instead of participating in the cumbersome process of attending in person at the place where the drawee's books were kept, a payee became cognizant of the option of noting the transfer of the debt owed to him on the bill itself. Effectively, this was what we call today endorsement.<sup>291</sup>

<sup>288</sup> See cites in n 42 above.

<sup>289</sup> In the materials available to me I did not find any discussion on the point.

<sup>290</sup> Mueller, above n 34 at 49, quotes a 1494 source speaking of 'the registration of the transferred claim' in a banker's books 'as authoritative as a notarial instrument since it is backed by the government.'

<sup>291</sup> De Roover, *Lettre de Change*, above n 42 at 86–87, 98–100.

Thus, at its inception, as it is nowadays, the endorsement has been a mechanism under which the payee, in possession of the bill, instructs the drawee to pay a transferee, by signing on the bill itself, and delivering the signed instrument to the transferee, who has thus come to be known as the endorsee. The mechanism came to correspond to the posting of entries under a merchant book-transfer; thus, it made the drawee liable directly to the endorsee, who by analogy to the transferee on a merchant book-transfer, remained entitled to recourse from his own original debtor, viz the payee on the bill. In this sense, the endorsement turned out to become more than a mere transfer of the claim against the drawee; rather, it evolved to be the equivalent of a domestic bill of payment standing on its own. On that notional bill, the payee-debtor instructed the drawee to pay the endorsee-creditor; thereby, as explained further below, the payee-debtor made the drawee-paymaster liable to the endorsee-creditor instead of to himself, the payee-debtor, while, as in a merchant book-transfer, remaining himself liable to the endorsee-creditor. The endorsee, in possession of the instrument, became entitled not only to recover from either the drawee or payee; rather, he also became entitled to endorse the instrument to a subsequent endorsee, thereby giving the latter the option of suing the drawee, payee, or himself, the intervening endorser. The process could repeat itself indefinitely.<sup>292</sup>

One may easily speculate how the drawer could not have escaped his own liability to the holder. Thus, somewhere in the process, it must have become apparent that if an endorser, who is to be considered as a drawer of a new bill, is to be liable to any subsequent endorsee, it must be that the drawer himself had incurred liability on the bill running to the holder. Whatever doubts may have pre-existed, as discussed in the previous section, they must now have come to rest. An order to pay on a bill, if by endorser then certainly by drawer, became the equivalent of a 'book transfer' carried out, not on books, but rather on the instrument.

Originally, the endorsement practice was of small scale. Hence, the transformation it precipitated was gradual. The significant expansion of the endorsement practice during the second half of the seventeenth century and throughout the eighteenth century<sup>293</sup> can be attributed to the relaxation and ultimate demise of usury prohibitions.<sup>294</sup> Getting rid of these restrictions permitted the sale and purchase of debts payable in the future for immediate cash reflecting their present value. Thus, a payee would use the debt owed to him not merely to pay his own debt, but also to obtain for it immediately its present value, thereby effectively 'accelerating' payment on the debt due to him. Stated otherwise, rather than having a bill endorsed in payment of a past debt, a bill could be endorsed

<sup>292</sup> See in general, De Roover, *ibid* at 116–18. Of course, the action against the drawee was premised either on his acceptance or the transfer of *la provision*.

<sup>293</sup> For the timeline, see text at nn 249–54 above.

<sup>294</sup> De Roover, *Lettre de Change*, above n 42 at 19 and in greater detail, De Roover, 'Dry Exchange', above n 32 at 194–99 where he points out at 194 that initially '[o]wing to the usury prohibition, interest had to be concealed and was included in the price at which bills were bought and sold.'

for the purpose of raising funds against it, with the endorsement serving as a basis for the liability to repay those funds. In short, the credit function of the instrument took over so as to prevail over its payment function. As discussed below in chapter ten section 2.2, new types of banks came to provide liquidity to the marketplace by purchasing, by means of obtaining by endorsement, bills of exchange. Ultimately, as already indicated, a fully fledged banking practice premised on discounting endorsed bills of exchange has its origin at the end of the seventeenth and beginning of the eighteenth centuries in England; it then spread to the Continent towards the end of the eighteenth century.<sup>295</sup>

Indeed, the effect of 'endorsement' was more than to add a party liable on the instrument and to replace the payee by an endorsee as the party entitled to recover from the drawee. Rather, in so replacing the payee by an endorsee, the new practice created upheaval in the entire legal scheme on which the Medieval bill of payment was premised, so as to shift the 'balance of power' in relation to the instrument. This was so since, unlike the payee, the endorsee was unlikely to be associated with the remitter; that is, the endorsee was typically a random creditor of the payee, with a right of his own to receive payment, unlinked to the remitter's right to receive payment from the drawer.

As already indicated above in section 4 of this chapter, the Medieval law that made the remitter the 'master' of the bill, with an indefinite right to countermand payment and demand repayment from the drawer, was premised on the remitter's association with the payee, namely, on the remitter's entitlement as the principal one on the bill. It was the remitter who delivered the funds to the drawer and who was thus entitled to the performance of the contract or at least to the repayment of the loan he had effectively given him. True, the payee who received the bill may have become entitled to be paid by the drawee, and yet, this was in performance of the remitter's contract with the drawer so as to leave the remitter in control throughout. Conversely, under the early post-Medieval law, an independent endorsee had a right of his own, that logically ought not to have been made subject to that of the remitter. Stated otherwise, the endorsement practice would not have made any business sense had the remitter remained in control upon his surrender of the possession of the bill.

Regardless, the use of the bill of exchange exclusively as a mechanism for the execution of a foreign exchange contract ceased to exist; rather, domestic or inland bills of exchange, designed to move funds from place to place in the same country and currency emerged to co-exist with the 'outlands' ones.<sup>296</sup> It appears that a pioneering role in this direction was played by England. Thus, over the years, a practice had developed under which English garment manufacturers in the countryside used London factors as selling agents. The latter sold on credit terms. It became common for English country manufacturers to draw on their London factors bills of exchange payable to the manufacturers'

<sup>295</sup> De Roover, *Lettre de Change*, above n 42 discusses bill discounting at length at 119–42.

<sup>296</sup> Marius, above n 163 at 3.

wool suppliers, against which the wool suppliers would provide the manufacturers with wool.<sup>297</sup>

With the growth in importance of the endorsement practice, and the emergence of domestic uses to the bill that had nothing to do with the execution of a foreign exchange contract, the remitter was called upon to recognize that he ought to surrender his control once he has released the instrument; he was thus forced to concede that in delivering the money to the drawer with the view of repayment elsewhere, he launched a process resulting in conferring the position of 'master' on the person in possession of the instrument issued in return to the delivery of the money. This new 'master' is to be referred to as its holder. Thus, the remitter himself remains in control and is entitled to revoke the process only as long as the instrument is in his possession; once the instrument reaches the payee, and any subsequent endorsee, it is the person in possession who is to become the primary beneficiary of the instrument. It is as a result of this process of transformation that it became possible to say that the bill of exchange inures to the benefit of the holder.<sup>298</sup>

For his part, a remitter who sends a bill to a payee is to count on the payee for giving him the value under the transaction between them. Stated otherwise, the remitter obtains the instrument from the drawer in return for value the remitter provides to the drawer, usually in the form of either cash or debit to an account. In turn, the remitter sends the bill to the payee for value provided or to be provided to the remitter by the payee. Such value may be provided, for example, in the form of goods sold or services provided by the payee to the remitter.<sup>299</sup> In fact, this is the same use Huvelin and Holdsworth attributed to the original late Medieval bill of payment.<sup>300</sup> Nevertheless, and this has become increasingly predominant, a bill of exchange may be issued by a drawer owing directly to the payee, reflecting the drawer's indebtedness to the payee under a transaction between them, with no involvement whatsoever of a remitter, who has become a non-essential (though possible) participant in a bill of exchange transaction.<sup>301</sup>

Thus, it was the endorsement that transformed the instrument from a bill of payment, on which the remitter is the primary beneficiary all along, to a bill of exchange, on which the person in possession is the principal beneficiary. In the process, the remitter has become dispensable; where he participates in a bill of exchange transaction, his rights on the bill are limited to the time the bill is in his possession, prior to sending it to the payee.

Arguably, it is only in the context of this transformation that Huvelin's analysis, discussed in section 4 of this chapter, fits in. Effectively then, the process involved the transformation of the bill of payment into a bill of exchange as a

<sup>297</sup> For a detailed discussion, see Rogers, above n 144 at 100–16.

<sup>298</sup> See in general, De Roover, *Lettre de Change*, above n 42 at 89–94 and 115–18.

<sup>299</sup> See eg sources cited in n 173 above.

<sup>300</sup> See text around nn 139–40 above.

<sup>301</sup> Among statutory sources enumerated in n 91 above, only U.C.C. Article 3 specifically defines it. See U.C.C. §3-103(a)(15).



side-effect of the incorporation into the bill of payment features of the non-bank or merchant book-transfer.

One hurdle to be overcome in the process was the drawee's consent to each transfer. Thus, in the bank book-transfer, the consent and active involvement of the paymaster was an indispensable element.<sup>302</sup> Naturally, the endorsement practice was meant to operate smoothly without involving the paymaster-drawee in each transfer. This led to a departure from the book-transfer practice and was achieved by using one of two types of texts on a bill. Thus, a bill could be drafted so as to instruct the drawee to pay not simply to a named payee. Rather, under one option, a bill could be drafted so as to instruct the drawee to pay the bearer. Alternatively, a bill could be drafted so as to effectively instruct the drawee to pay a named payee or his order.<sup>303</sup>

These were two separate options; an endorsement naming the endorsee ('special endorsement') was required only for the second one, that of a bill payable to the order. In the first case, that of a bill payable to the bearer, the instruction was to pay whoever presents the instrument.<sup>304</sup> Such an instrument became transferable by the mere delivery from one person to another. In the latter case, that of a bill payable to the order, the instruction was to pay either the payee or the named endorsee who presents the bill. Such an instrument was transferable by delivery and endorsement, consisting of the endorser's signature instructing payment to the designated endorsee. An endorsement not designating an endorsee, consisting of a mere signature, became known as a blank endorsement;<sup>305</sup> its effect has been to convert an instrument payable to order to an instrument payable to the bearer.<sup>306</sup>

Either way, upon acceptance, the drawee effectively undertook to pay not exclusively the person to whom the remitter sent the instrument, but rather the holder at the time. Having so agreed in advance, it became superfluous to seek his consent in connection with each individual transfer.

By the mere delivery of an instrument payable to the bearer, each holder transferred his right to a subsequent holder. In the absence of a signature, he did not incur liability on the instrument. Whether or not he gave an instruction to the drawee may depend on the way we interpret the drawee's undertaking. No such ambiguity exists with respect to the endorsement of a bill payable to the order. Thus, by endorsing a bill payable to order, the endorser both instructed

<sup>302</sup> See text around nn 44–46 above.

<sup>303</sup> In fact, these are the two categories that had crystallized over time. Original classification was more detailed. Eg, Holdsworth above n 20 at 114 speaks of four types consisting of 'certain documents, in which a person places himself under a liability to pay or perform something, either (a) to the creditor or to someone else nominated by the creditor and producing the document, or (b) to the nominee of the creditor producing the document, or (c) to the creditor or the producer of the document, or (d) to the producer of the document simply.'

<sup>304</sup> So as to bring upon itself the wrath of Marius, above n 163 at 13–14 who characterized the practice as dangerous in case the instrument reaches wrong hands.

<sup>305</sup> For such an endorsement see eg Marius, *ibid* at 30. Interestingly, while being explicitly judgmental of the practice of issuing bearer bills (*ibid*), he does not disapprove of blank endorsements.

<sup>306</sup> See n 94 above.

the drawee to pay the specific successive holder and incurred liability on the bill equivalent to that of the drawer. He also transferred his own right to that successive holder.

There has however been an intense scholarly debate on the nature of the endorsement of a bill payable to order and the theoretical basis under which it achieves the above.<sup>307</sup> In a nutshell, the principal options are of (i) cession and novation; (ii) an undertaking in favour of a third party; (iii) unilateral promise; and (iv) an undertaking towards the original holder to pay exclusively to the presenting holder. These options can be set out as follows.

First, in accepting the bill, the drawee could have been looked upon as making the promise to the payee. On its own, the endorsement accomplished a transfer, tantamount to *cessio*, giving each subsequent holder a derivative right against the drawee. In turn, the drawee's consent, given in advance, may have served as a *novatio*, so as to form the basis for a direct nexus between the drawee and each successive holder, as in the bank book-transfer.<sup>308</sup> Arguably, *novatio* was used to establish grounds for an autonomous obligation of the drawee, giving the holder an abstract right to the entire sum payable, free of defences of prior parties. However, this feature of *novatio* appears to be superfluous, where the original obligation to the first holder was already autonomous, a point to be discussed further below. Arguably then, the *novatio* mechanism was an 'inheritance' from the theory underlying the bank book transfer. Alternatively, it may have been provided to meet possible doubts as to the existence of either effective *cessio* or an autonomous drawee's obligation to the original payee. Or else, under another alternative, *novatio* was utilized simply to strengthen the rights of the holder, particularly over procedural hurdles on the way of the cessionary to enforce his right; such hurdles certainly persisted even after the early post-Medieval era.<sup>309</sup> From this perspective, *novatio* leading to a drawee's direct engagement to the holder was a crutch to support the holder's derivative right against the drawee.

Other alternative theories, applicable both to bills payable to the order and bills payable to the bearer, dispensed with *novatio*; they nevertheless relied on the drawee's advance engagement. Thus, under a second alternative, the drawee's acceptance engagement on a bill was viewed as an undertaking in favour of a third party. The relevant third party, in whose favour the drawee's engagement endures, is the holder on maturity.

A third alternative was to view the drawee's engagement on a bill as a unilateral promise of the drawee to pay the presenting holder, whoever he may be. Under this view, the drawee's promise was in the form of an offer that ran in favour, and was to be accepted,<sup>310</sup> only by the last holder who pre-

<sup>307</sup> For an extensive discussion of various positions in France and Germany see L. Debray, *La Clause à Ordre*, (Paris: A. Giard & E. Brière, 1892) at 61–132.

<sup>308</sup> See text subsequent to n 42 above.

<sup>309</sup> See ch 5, section 9, text around n 245 above.

<sup>310</sup> 'Accept' is used in this sentence by reference to the drawee's offer and not the drawer's order.

sented it on maturity. Of course, this offer by the drawee was to be treated as irrevocable.

Each of these second and third alternatives was premised on a direct drawee's obligation to the holder and yet did not envisage any novation of the drawee's obligation in order to create the direct link between him and the presenting holder. Both viewed the relationships among successive holders as based on a cession, namely the assignment of the previous holder's right, and eliminated novation altogether. Under the second alternative, the transfer was that of the right under a contract in favour of a third-party beneficiary, while under the third alternative it was the transfer of an irrevocable offer that has not been ripened to an obligation.

Finally, under a fourth alternative, the drawee's obligation to pay either the order or the bearer, served, in each case, as an undertaking to pay exclusively the holder presenting the bill, and not a predecessor, so as not to facilitate the discharge of the obligation except by payment upon presentment. As under the third alternative, the obligation to pay the presenting holder existed as of the issue of the instrument. However, unlike under the third alternative, under the fourth one, when the bill was issued, the drawee's undertaking ran exclusively in favour of the original holder, so as to be transferable to each successive holder. Transfer was by the endorsement of a bill payable to order and the delivery of a bill payable to order. Thus, each subsequent holder was a transferee of the right of the first holder under which payment was to be made upon maturity to the presenting holder. This would make the presenting holder's right as based on *cessio*, and give rationale to the order or bearer clause, without invoking at all *novatio*.

It is of course possible that all the rationales outlined above for the order and bearer clauses co-existed, so that the drawee's direct obligation to the holder served multiple purposes.

As already demonstrated in this study, 'bearer' and 'order' clauses go back to Antiquity.<sup>311</sup> However, throughout the Middle Ages, their treatment had a checkered history. For a long time the effect of such clauses on a subsequent holder of a bill, namely, either a bearer other than the original bearer of an instrument payable to the bearer, or the endorsee in possession of a bill payable to the order, had been doubted. Particularly, it was disputed as to whether these clauses confer on a subsequent holder an entitlement to recover on the instrument in his own right, and not only to collect payment on behalf of the original bearer or payee. Ultimately, the former view, conferring on each holder an independent right of recovery, prevailed, so as to dispense altogether with the drawee's consent for each transfer.<sup>312</sup> At the same time, as indicated, whether the subsequent

<sup>311</sup> For bearer clauses in Ancient Mesopotamia, see ch 3, section 2 above. For their reappearance in Islamic payment instruments, see ch 6, section 3.1 above. For the equivalent of an order clause under the Talmud, see ch 7, section 2.2 and section 3 above. For an order clause in Ancient Greece, see ch 3, section 3 above.

<sup>312</sup> The evolution is outlined by Holdsworth, above n 20 at 113–26, as well as by De Roover, *Lettre de Change*, above n 42 at 87–94. For detailed discussions see H Brunner, 'Les Titres au Porteur Français du Moyen-Age' (1886), 10 *Nouvelle Revue Historique de Droit Français et Étranger* 11 (Parts I–III) and 139 (Parts IV–V); and L Debray, above n 307. See also MG Des Marez, above n 103, particularly at 538.

holder's right is premised on *novatio* of the drawee's obligation or on a *cessio* of the previous holder's right (or even a direct right accorded to the presenting holder) may have not been settled.

Next to be discussed is the scope of the entitlement of the holder from the drawee. The issue concerns the autonomy of the obligation on the bill of exchange, namely whether the holder was accorded an 'abstract' right, entitling him to recover the stated sum of money, free of defences available to parties in their bilateral relationships. The ensuing discussion is based on the fact, already mentioned, that the holder's right is not premised on the drawee's consent given to each holder individually. The right and its scope must thus be theorized in light of this fact.

Certainly, as indicated, the drawee's obligation to each holder other than the original one could have been based on *novatio*, which could have supported an autonomous obligation. Without rejecting this option, the ensuing discussion will endeavour to examine the nature of the drawee's obligation from its inception and ultimately to establish the basis for an autonomous obligation towards all holders, including the first one.

In theory, there are several options as to the scope of the drawee's undertaking. First, the drawee may agree to pay the sum of the instrument subject to the defences available against each specific holder in his own bilateral relationship from the party from whom he received the bill. This option is however to be disfavoured; being premised on a different obligation of each signing party, it undermines the certainty of the value of the recourse available to each holder against a prior party. Second, the drawee may become bound by the drawer's obligation to the remitter, so that defences available to the drawer against the remitter are available to the drawee in defending the action of each holder. Third, the drawee may become bound by the remitter's obligation to the payee, so that defences available to the remitter against the payee<sup>312.1</sup> are available to the drawee in defending the action of each holder. Fourth, where there is no remitter, the drawee may become bound by the drawer's obligation to the payee, so that defences available to the drawer against the payee are available to the drawee in defending the action of each holder. Subsequent parties may be unfamiliar with the origins of the instrument, and may not know whether there was or there was not a remitter; thus all these options appear inappropriate. So far as I can see they have not been seriously considered.

Hence, two other, more credible, options are to be discussed. As a matter of logic, the drawee could have given his consent to pay the amount he owed to the drawer, that is, the amount of the bill, either subject to any defences he may have against the drawer, or in its entirety, irrespective of such defences. The former possibility could be premised on *cessio*; both possibilities could be

<sup>312.1</sup> As eg, where the remitter paid by bill for goods that were not provided to him by the payee in breach of their contract.

based on the drawee's agreement. It is at this point that the two alternatives offered by Huvelin fit in; the theory of the drawee's liability to the holder is either on the transfer of *la provision*, in which case the holder's right is subject to the drawee's defences, or on the drawee's acceptance, which is taken to be autonomous.<sup>313</sup>

The approach universally adhered to, reflected in modern legislation,<sup>314</sup> is however that of the autonomy of the acceptor's obligation. Indeed, under French law the drawee is liable to the holder on *la provision*, irrespective of acceptance. A holder suing on *la provision* does not have an autonomous right; rather, he is subject to the drawee's defences against the drawer; moreover, until the maturity of his claim, the holder's right against the drawee who has not accepted may even be defeated by the drawer's unilateral reclamation of *la provision*. Being fragile,<sup>315</sup> the right to sue the drawee on *la provision* is thus of practical importance only where and as long as the drawee did not accept; effectively, the precarious holder's right to enforce the drawee's obligation on *la provision* is superseded by the holder's more solid right to sue the drawee-acceptor on the latter's autonomous obligation on the acceptance.<sup>316</sup>

The autonomy of the drawee's obligation, running in favour of the holder, whether by transfer or novation, 'perfects' the negotiability of the instrument, namely, its transferability from hand to hand (whether with or without endorsement), free of prior-parties' contract defences and third parties' property adverse claims. From this perspective, negotiability has been the result of the transformation of the instrument and its adaptation to new uses, rather than, as may be suggested by Holdsworth,<sup>317</sup> an improvement or enhancement per se of its capabilities.

Evolution did not stop with the recognition of autonomy. Ultimately, when the dust settled at the dawn of the modern era, pragmatism prevailed and consideration was given to the relationship between the 'autonomous' obligation on the instrument and the one with which it paid. Notwithstanding the absolute language in which the acceptor's liability is stated by statute,<sup>318</sup> autonomy was made to exist only towards a remote party acting in good faith with whom the

<sup>313</sup> See text around n 215 above.

<sup>314</sup> For acceptor liability to the sum of the bill, see BEA s 54(1); Geneva Bills Convention art 28; U.C.C. §3-413; UNCITRAL Bills Convention art 40. For the citation of each of the four sources, see n 91 above.

<sup>315</sup> Gavalda and Stoufflet, above n 178 at 111. For a concise analysis see Ripert and Roblot, above n 178 at 185. *La provision* is not a present debt owed by the drawee to the drawer that may be payable only in the future; rather it is a debt between them that may exist upon the maturity of the bill of exchange. Hence, unlike the assignment of a debt, the transfer of *la provision* by the drawer to the payee, and onward to an endorsee, does not preclude the drawer from revoking his order to the drawee (who has not accepted the bill) so as to extinguish the holder's right against the drawee. See Lescot and Roblot, above n 178 at 429.

<sup>316</sup> In France, Art L 511-7(3) of the Code of Commerce (*Code de Commerce*, Version consolidée au 1 décembre 2009) provides for the transmission of '*la provision*' into the hands of each successive holder. The acceptor's liability is governed by Art L 511-19 of the Code of Commerce. See Gavalda and Stoufflet, *ibid* at 109, 101, respectively. For a discussion on the coexistence of the holder's right to the provision and to sue the acceptor, see also Ellinger, above n 178 at 112.

<sup>317</sup> Above n 20 at 144.

<sup>318</sup> Above n 316.

drawee has not dealt. Otherwise, defences arising from the underlying transaction are not forfeited altogether; they remain available to a party liable on the instrument against the one with whom he is in privity, and in fact, against any transferee other than in good faith.<sup>319</sup> In the process, as pointed out below in chapter eleven, section 6.3, novation was abandoned, and transfer free of equities replaced a mere transfer.

Looking at the matter in a broad historical perspective, it is arguably Roman law from which the concept of autonomous obligation conferring an abstract right is derived.<sup>320</sup> Surely, an abstract right to enforce an autonomous obligation enhances the circulation of the bill of exchange. Indeed, the doctrine underlying autonomy under the law of bills of exchange has been transformed, as it does not stand on its own any more. Rather, it has become dependent on the holder's remoteness and usually on the circulation of the paper. Yet, its Roman traces are to be acknowledged. Roman law thus appears to be a source of inspiration for a doctrine underlying the implementation of an important commercial law policy.

## 6. CONCLUSION: MEDIEVAL CONTINENTAL CONTRIBUTION ASSESSED

Having discussed Medieval private and public banks, De Roover summarized that:

From the sixteenth century until the end of the eighteenth century, the banking system on the European Continent was made up of public banks, which continued the functions inherited from the medieval money-changers, and of private bankers or cambists who, also in accordance with traditions dating back to the Middle Ages, were mainly exchange dealers. In all the manuals of the seventeenth and eighteenth centuries, a banker is defined as a dealer in bills of exchange who operates with correspondents abroad and speculates on the rates of exchange.<sup>321</sup>

It is in this institutional framework, as it has evolved since the twelfth century, that Medieval non-cash payment facilities have developed. Thus, the bank book-transfer and the emergence of cheques are developments that took place in activities of moneychangers turned deposit bankers and their successors, the public banks. At the same time, the bill of exchange, including its predecessor, the bill of payment, evolved as part of the activities of exchange dealers, namely private merchant bankers.

<sup>319</sup> See eg L Dabin, *Fondements du Droit Cambiare Allemand* (Liège, Faculté de Droit de Liège, 1959) at 204–13, 261–66, 334–43 and 422–27 (for Germany); C Gavalda and J Stoufflet, *Instruments de Paiement et de Crédit*, 7th edn edited by J Stoufflet (Paris: LexisNexis, 2009) at 59–61 and 77 (for France); and Ripert and Roblot, above n 178 at 144, 156–60, and 216–20 (for France with a comparison to Germany). For an extensive discussion see Lescot and Roblot, above n 178 at 98–120.

<sup>320</sup> For an autonomous obligation under perfect execution of delegation in Roman law, see ch 5, sections 6–7, above. For the 'adaptation' of Roman law in the Middle Ages and shortly thereafter, see above, section 4 of this chapter.

<sup>321</sup> De Roover, 'New Interpretations', above n 3 at 229.

As a form of financial intermediation, banking did not thrive in the Middle Ages. Thus, private deposit-banks failed; their successors, the public banks, did not lend to the public and thus were not financial intermediaries in the full sense of the term. For their part, exchange bankers did not perform financial intermediation at all. Loans were made mostly out of capital and certainly not out of deposits. At the same time, perhaps counter-intuitively, non-cash payment techniques developed throughout the era. In my view, this is particularly attributed to the credit features of the bill of exchange that made it a widely used instrument.

Both bank book-transfers and payment instruments, including cheques, preceded developments in Medieval Continental Europe.<sup>322</sup> In fact, as demonstrated in chapter three above, deposit banking, as an institutional framework for such activity, emerged far earlier in Antiquity. It is hard to tell how much and, if at all, Medieval re-introduction was conscious of that prior development.

In contrast, the bill of exchange appears to be the creation of Medieval Continental Europe. Building on the flexibility of concepts inherited from Roman law, as set out in chapter five above, Medieval law facilitated the crystallization of its legal features as a credit and payment mechanism. Ultimately, however, the bill of exchange was transformed from a payment and credit facility, into predominantly a credit tool, and yet, as will be seen below in chapter eleven, section 5, it came to confer its features on the cheque. More generally, the post-Medieval banking system in England transformed into the true machinery for financial intermediation; as outlined below in chapter ten, this transformation enhanced non-cash payment facilities developed in the Middle Ages and built on them the foundation of the modern payment system. In the final analysis, while having been subsequently transformed, elements of Medieval banking, cheques, and bills of exchange, whether original or not, heralded the modern banking and payment systems.

A distinctive contribution of the Medieval era is the settlement procedure for bills of payments conducted by merchant bankers in fairs. This procedure is the forerunner of organized multilateral interbank clearing. Nevertheless, its own operation was premised on bilateral netting, except that it also allowed substitution of debtors by agreement. More specifically, this was not a true multilateral clearing facility; rather, the procedure was premised on a series of co-ordinated bilateral nettings occurring in an organized multilateral setting, allowing the substitution of debtors so as to enhance savings in actual payments. Indeed, bilateral and even multilateral netting, practiced in isolation by banks on ad hoc basis, had been already known in Antiquity;<sup>323</sup> at the same time, the Medieval fair interbank facility was premised on all pairs acting in a multilateral setting and taking advantage of this facet by allowing substitution. This was performed in the context of a multilateral organization, and heralded

<sup>322</sup> See ch 3, sections 3–5 above.

<sup>323</sup> For origins in Ancient Greece, see ch 3, section 3 above.



the next transformative step, that of the clearing house with its multilateral netting. Thus, historically, the Medieval fair interbank facility was the genesis of the interbank clearing house, and led to the performance of interbank multilateral clearing.

Finally, the question as to whether the bill of exchange is an original creation of early post-Medieval Europe, or whether it is an adaptation of an earlier facility from elsewhere, is to be addressed.

As already indicated above in chapter six, section 4, in his monumental work on the history of English law, Holdsworth is sceptical as to whether the modern bill of exchange is a true derivation from the business practices of the Muslim Arabs. He nevertheless speaks of the Arabs using ‘something very much like the modern bill of exchange’ that, as early as the eighth century CE:

could pass from hand to hand by something very much like an indorsement; and, to use modern terms, the payee [thereof] had a right of recourse against the drawer in the event of non-payment by the acceptor.<sup>324</sup>

Analysis in chapter six above does not support this specific observation. First, the eighth century may be too early a milestone, at least for a solid record of Medieval Islamic payment instruments. Second, there is no indication that at any time Medieval Islamic payment instruments were endorseable, that is, that their transfer was accomplished by the delivery plus the endorsement signature by the transferor of the instrument. Third, in the case of default by the paymaster (corresponding to the drawer), Islamic rules of the two leading schools permit recourse by the creditor-payee against the paymaster-drawer (as well as against the debtor) only under narrow circumstances.<sup>325</sup>

There are two other dissimilarities, albeit not denied by Holdsworth, but nevertheless worth mentioning, between the Islamic payment instrument and the Continental Bill of Exchange. First, unlike in connection with the Continental bills, there was neither currency conversion nor a genuine credit element to the Islamic *suftaj*; rather it served exclusively to facilitate the transmission of a sum of money from place to place. The second dissimilarity, relating to the autonomy of the obligation, is even more fundamental. Thus, for its part, unlike the law that developed to govern the post-Medieval Continental bill of exchange, Islamic law did not accord a payee-creditor an ‘abstract’ right, namely, an entitlement from the paymaster or his correspondent (respectively, corresponding to the drawer or drawee) to a sum of money to which the obligation relates, free of defences available to the parties in their bilateral relationships.<sup>326</sup>

At the same time, the analysis of chapter six supports the position that under Islamic law the Maliki *hawale* heralds negotiable instruments in two fundamental ways. First, Maliki law of the early Middle Ages provides for solid rules to

<sup>324</sup> Holdsworth, above n 20 at 133, whose observation to that effect is the starting point of Holden, above n 93 at 1. Holdsworth is explicitly relying on Huvelin, ‘Travaux’, above n 37.

<sup>325</sup> See ch 6, section 4 (conclusion).

<sup>326</sup> *Ibid.*

govern a simplified procedure for the transfer by delivery of informal debt instruments (albeit without an endorsement). Second, the *suftaj* accords to the creditor (corresponding to a payee) a direct entitlement against the paymaster (corresponding to the drawer) – at least prior to presentment – as well as his correspondent (corresponding to the drawee).<sup>327</sup>

Nevertheless, the balance of probability is against direct Islamic ancestry. This is particularly so on the basis of the origins of the post-Medieval Continental bill of exchange from its direct predecessor, the Medieval Continental bill of payment. Indeed, there are similarities between the early Medieval Islamic payment instruments and the much later post-Medieval Continental bill of exchange, in terms of both transferability by delivery (though not endorsability) and the independent right of the holder. At the same time, the Medieval Continental bill of payment, which existed between these two instruments, was entirely different; it was neither transferable nor controlled by the holder. It is more likely that in Continental Europe, the bill of payment evolved into a bill of exchange as outlined in section 5 of this chapter rather than as an importation from early Medieval Islam.<sup>328</sup> The similarity between the Islamic payment instruments and the later bill of exchange is thus a historical coincidence; the bill of exchange that evolved out of the bill of payment is in fact an improved Islamic *suftaj*; and yet the process of evolution was out of the bill of payment and not the *suftaj*.

Indeed, in the early part of the Middle Ages, during the first millennium, economic life in Europe was dormant. During that period, rules concerning transferability of payment instruments and the entitlement to sue on them existed in the Near East not only in Islam but also under the Jewish Talmud.<sup>329</sup> It is certainly a legitimate matter of speculation as to whether these rules and the doctrines that shaped them did not play an indirect implicit role in the evolution of the bill of exchange in early post-Medieval Continental Europe. Nevertheless, direct ancestry seems improbable.

Holdsworth's scepticism as to the Islamic origin of the Continental bill of exchange is thus well founded, and yet it is his own observations that provoke thoughts to the contrary. At the same time, these observations appear to be misguided. In heavily relying on Huvelin, Holdsworth may have been misled so as to lose sight of the timeline, and thus attributed to the earlier Medieval Continental bill of payment features of the subsequent post-Medieval Continental bill of exchange. In so doing, he may have inadvertently given exaggerated credence to

<sup>327</sup> *Ibid.*

<sup>328</sup> This is not to deny the existence of commerce between East and West, so as to give rise to the possibility of familiarity in Europe with the Islamic *suftaj*. For East-West Medieval commercial contacts, see eg EH Byrne, 'Commercial Contacts of the Genoese in the Syrian Trade of the Twelfth Century' (1916), 31 *Quarterly Journal of Economics* 128 at 157. See also Sayous, 'Marseille avec la Syrie', above n 158.

<sup>329</sup> *Ibid.* The transfer of note of indebtedness under Talmudic law is discussed in ch 7, section 2.2, text and nn 61–90 above. And yet the attribution of the invention of the bill of exchange to the Jews, alluded to by JB Martin, *'The Grasshopper' in Lombard Street* (New York: Burt Franklin, reprint 1968, originally published: London, 1892) at 112–13, does not seem to be supported by evidence.

the possibility of direct Islamic influence. In the final analysis, however, my thesis is that the bill of exchange developed on its own, to meet ongoing demands of trade and trade finance as they had been evolving in a changing world. Indirect influence of earlier payment instruments, and possibly legal doctrines from elsewhere, may have occurred; as well, enhanced procedures for the efficient enforcement of rights on bills of exchange may have been put in place with a view to facilitating commerce.<sup>330</sup> Ultimately, however, revised concepts derived from, or at least inspired by, Roman law served as the primary building blocks in the adaptation of the legal system to cover this new facility.

<sup>330</sup> See eg Asser, above n 219 at 113.

# Payment Orders under English Common Law: The Bailment of Money and the ‘Reception’ of the Bill of Exchange

|                                                                                          |     |
|------------------------------------------------------------------------------------------|-----|
| 1. Introduction                                                                          | 423 |
| 2. Bailment of Money and the Bailor-Bailee Relationship                                  | 425 |
| 3. The Beneficiary’s Right to Bailed Funds                                               | 433 |
| 4. The ‘Reception’ of the Bill of Exchange – Payee’s Remedy                              | 442 |
| 5. The Bailment of Money and the Bill of Exchange as Payment<br>Mechanisms: A Comparison | 453 |
| 6. Conclusion                                                                            | 464 |

## 1. INTRODUCTION

THIS CHAPTER PRESENTS the late Medieval and early post-Medieval<sup>1</sup> historical foundations of funds transfer law in England as of the Norman Conquest in 1066 CE. The chapter first examines (in sections 2 and 3) the Medieval law governing the bailment of money.<sup>2</sup> Subsequently, it discusses (in section 4) the reception of the bill of exchange to English law in the later Middle Ages and the early post-Medieval period. Finally, section 5 analyses legal doctrine pertaining to each facility as forming the basis for a law to govern payment mechanisms. The conclusion in section 6 highlights the Medieval evolution by reference first to the Roman law delegation and the Islamic *hawale*, and second, to some aspects of modern law.

<sup>1</sup> For general comments regarding the time line and relation to Continental developments, see opening paragraph of ch 8 above.

<sup>2</sup> See eg RM Jackson, *The History of Quasi-Contract in English Law* (Cambridge: Cambridge University Press, 1936) at 24–26, 30–31; JB Ames, ‘Account’ in JB Ames, *Lectures on Legal History and Miscellaneous Legal Essays* (Cambridge, Mass: Harvard University Press, 1913) at 116, 117–20; CD Hening, ‘History of the Beneficiary’s Action in Assumpsit’ in AALS (ed), *Select Essays in Anglo-American Legal History* (Frankfurt: Verlag Sauer & Auvermann KG, 1909, reprint 1968) vol III 339 at 344–60; and AWB Simpson, *A History of the Common Law of Contract: The Rise of the Action of Assumpsit* (Oxford: Clarendon Press, 1975) at 182–85.

The chapter examines the evolution of the law governing the bailment of money and bills of exchange in the context of the development of the law governing civil liability in the common law. Regarding the bailment of money, it first discusses, in section 2, the Medieval foundations of English law that governs the bank deposit. Second, the chapter goes on to discuss, in section 3, the rise and fall of a Medieval doctrine that facilitated the transfer of the deposit. That Medieval doctrine was lost in the transition to modern law.

In dealing with the bill of exchange, the chapter rejects the existence of 'Law Merchant' as a separate and distinct branch of law that was 'received' from the Continent together with the bill of exchange itself. Thus, the chapter departs from the orthodox position<sup>3</sup> on the matter, and adopts a revisionist view.<sup>4</sup> Thereunder, the bill of exchange had been accommodated by the common law as part of the common law's own post-Medieval development and growth process. That process was designed to achieve the establishment of a modern expansive theory to govern civil liability in general. Two premises underlie this proposition. First, it is supposed that in the transformation of the letter of payment to the bill of exchange in the early post-Medieval era, England was more than a passive observer or an importer; rather, England was an active participant. This was in fact demonstrated in section 5 of chapter eight above and will not be dealt with in this chapter. Second, as will be discussed in section 4 of this chapter, the absorption of the newly created bill of exchange into the English legal system was not a matter of receiving law from elsewhere; rather, it was a matter of indigenous common law doctrine.

Against this background, section 5 of this chapter endeavours (i) to address the suitability of the bailment of money and bill of exchange as mechanisms underpinning legal doctrine pertaining to funds transfer; (ii) to compare between the two mechanisms; and ultimately (iii) to examine their potential for convergence, although it failed to materialize. Convergence had been doomed when doctrine governing the bailment of money 'regressed' in the course of the nineteenth century and became incompatible with that underlying the bill of exchange. While this particular stage is beyond the relevant period of inquiry, it is addressed in this chapter in order to complete the picture of the subject.

Other than in passing in section 6 below, legal doctrine pertaining to the assignment of debts is not discussed in the chapter.<sup>5</sup> This is so since '[a]t com-

<sup>3</sup> For the orthodox perspective on the introduction of the bill of exchange as a payment mechanism, see eg W Holdsworth, *A History of English Law*, 2nd edn (London: Methuen, Sweet & Maxwell, 1937, reprint 1966) vol VIII at 126–40, 151–70.

<sup>4</sup> Whose leading proponent is JS Rogers, *The Early History of the Law of Bills and Notes: A Study of the Origins of Anglo-American Commercial Law* (Cambridge: Cambridge University Press, 1995).

<sup>5</sup> This is in contrast to ch 5, section 9 above, dealing with the cession of debts under Roman law. The objective of the Roman law discussion was to examine doctrinal foundations possibly affecting subsequent developments in the crystallization of funds transfer laws. In contrast, developments in England occurred centuries thereafter, at a point in time for which it is possible to state with confidence that the law of assignment of debts did not play any role in the early developments of English law pertaining to funds transfers.

mon law, . . . a debt was looked upon as a strictly personal obligation<sup>6</sup> and its assignment was prohibited.<sup>7</sup> Indeed, Courts of Equity viewed this resistance to assignability as ‘too absurd . . . to adopt’<sup>8</sup> and recognized the assignment of debts,<sup>9</sup> under which an assignee ‘take[s] his chance as to the exact position in which the [assignor] stands’<sup>10</sup> so as to be subject to the debtor’s defences against the assignor. In equity, notice to the debtor is not essential to establish the assignee’s title as between himself and the assignor;<sup>11</sup> rather, principles of equity require that an assignment will be created ‘by way of agreement, binding the conscience of the assignor.’<sup>12</sup> The assignor’s agreement is to be communicated to the assignee, whether directly or through the debtor.<sup>13</sup> As highlighted above in chapter one, section 4, a payment mechanism could have been premised on the assignment to the payee/creditor of the debt owed by the paymaster to the payer/debtor. However, Courts of Equity did not play any role in the early developments of payment mechanisms in English law; hence, any attempt to examine their operation under equitable principles is anachronistic and will not be undertaken in the present discussion.<sup>14</sup>

## 2. BAILMENT OF MONEY AND THE BAILOR-BAILEE RELATIONSHIP

The earliest writs for the recovery of a specific sum of money as well as a specific chattel under the Common Law of England were modelled on the *praecipe* writs, namely the Writs of Right for the recovery of land. Around the close of the twelfth century, in Glanvill’s time, they formed a composite writ originally encompassing Debt and Detinue. The ultimate split occurred towards the end

<sup>6</sup> *Fitzroy v Cave* [1905] 2 K.B. 364 at 372.

<sup>7</sup> The objections to assignability of choses in action in the common law are summarized eg by WR Warren, *The Law Relating to Choses in Action* (London: Sweet & Maxwell, 1899) at 31–32. They include maintenance, the duty of a debtor to seek out his creditor, and the need to complete transfer of ownership by means of physical delivery.

<sup>8</sup> *Master v Miller* (1791) 4 T.R. 320 at 341, 100 E.R. 1042 at 1053.

<sup>9</sup> According to M Furmston, *Cheshire, Fifoot & Furmston’s Law of Contract*, 15th edn (New York: Oxford University Press, 2007) at 644, this recognition goes back to the beginning of the seventeenth century. However, for tracing it to the beginning of the fifteenth century, see WT Barbour, ‘The History of Contract in Early English Equity’ in P Vinogradoff (ed), *Oxford Studies in Social and Legal History* (Oxford: Clarendon Press, 1914) vol IV at 108.

<sup>10</sup> *Mangles v Dixon* (1852) 3 H.L.C. 702 at 735, 10 E.R. 278 at 292.

<sup>11</sup> *Gorringe v Irwell India Rubber and Gutta Percha Works* (1886) 34 Ch. D. 128. At the same time, notice to the debtor is required to bind the obligor as well as (where this has not been superseded by statute) to defeat competing assignee. For the former point see eg *Stocks v Dobson* (1853) 4 De GMG 11, 43 E.R. 411. The latter point is the rule of *Dearie v Hall* (1828) 3 Russ. 1, 38 E.R. 475.

<sup>12</sup> *Tailby v The Official Receiver* (1888) 13 A.C. 523 at 546.

<sup>13</sup> *Delbrueck v Manufacturers Hanover Trust Co* 609 F.2d 1047 at 1051 (2nd Cir. 1979).

<sup>14</sup> For a contemporary comprehensive discussion on principles of equity (trust and assignment) relating to the payee’s position in a credit transfer, see RR Pennington, AH Hudson and JE Mann, *Commercial Banking Law* (Plymouth: MacDonald and Evans, 1978) at 283–91. See also B Geva, *Bank Collections and Payment Transactions: Comparative Study of Legal Aspects* (Oxford: Oxford University Press, 2001) at 266–70.

of the thirteenth century. Debt had come to provide for the recovery of a specific sum of money. Detinue had come to provide for the recovery of specific goods.<sup>15</sup>

Money enclosed in a chest, bag or other receptacle so as not to be used as current coin was recoverable in Detinue. In such a case, the recoverable object was not a sum of money, but the container enclosing the money. Such a 'box under seal', rather than the sum of money, was conceived as the specific chattel to be recovered in Detinue.<sup>16</sup>

The 'bailment of money' gave rise to some difficulties. In its simplest sense, the term means delivery of money. Case law was concerned with the failure of the purpose for which the money was delivered to the bailee. Hence, as a legal concept, the bailment of money denotes the delivery of money for a particular, or, in effect, any, given purpose.<sup>17</sup> Where the purpose was not carried out, inasmuch as the bailee was not obligated to keep the specific coins separately,<sup>18</sup> he was not liable to the bailor for the money in Detinue.<sup>19</sup> At the same time, Debt was originally perceived to lie either on an Obligation, namely a sealed deed, or on a Contract, namely on a 'real transaction' like sale or loan, where the defendant-debtor had received a material benefit, technically called *quid pro quo*.<sup>20</sup> Also, the action of Account was originally unpromising. To be accountable for property committed to his charge, the defendant must have acted as the plaintiff's guardian in socage, bailiff, or receiver.<sup>21</sup>

The breakthrough occurred in 1368. In a case decided that year,<sup>22</sup> the bailor was allowed to bring against the bailee either Debt or Account. In that case, 'the plaintiff bailed to the defendant £10 on condition that, if the defendant made him an assurance of certain land, the defendant should keep the £10, but that, if he did not make the assurance by a certain day, he should bail them back to the plaintiff.'<sup>23</sup> Claiming that the defendant had acted as his receiver and that he

<sup>15</sup> See in general, SFC Milsom, *Historical Foundations of the Common Law*, 2nd edn (Toronto: Butterworths, 1981) at 262–65; CHS Fifoot, *History and Sources of the Common Law: Tort and Contract* (London: Stevens & Sons, 1949) at 25–28, 217–18. See also TFT Plucknett, *A Concise History of the Common Law*, 5th edn (Boston: Little, Brown, 1956) at 363–65. Recovery of a specific amount of fungible (ie unascertained) goods fell under Debt.

<sup>16</sup> *Luffenham v Abbot of Westminster* (1313) Y.B. Hil. 6 Ed. II (43 SS) 65. See Fifoot, *ibid* at 27–28. Accidental loss of 'money delivered in keeping under seal . . . which could not be changed' is a defence in the bailee's hands. See *Anon* (1339) Y.B. 12 & 13 Ed. III (R.S.) 244 at 245–46.

<sup>17</sup> The term is used in numerous authorities. For a partial definition see Jackson, above n 2 at 24.

<sup>18</sup> As further discussed in text and nn 61–64 below.

<sup>19</sup> See text around nn 15–16 above.

<sup>20</sup> See in general, Fifoot, above n 15 at 223, 225–26. But see *Anon* (1294) Y.B. 21 & 22 Ed. I (R.S.) at 598: on a seller's failure to convey land fully paid for by the buyer Mettingham CJ would allow the buyer to 'demand the money by writ of Debt', as an alternative to his remedy to enforce the seller's Covenant. *Ibid* at 600. For the discontinuation of such "equity" jurisdiction' by common law courts in the earlier part of the fourteenth century, see Jackson, above n 2 at 20, relied on by Fifoot, *ibid* at 222, fn 33. For *quid pro quo* as reflecting reciprocity (or receipt in exchange) in Medieval informal contracts, see DJ Ibbetson, *A Historical Introduction to the Law of Obligations* (Oxford: Oxford University Press, 1999) at 80–83, 141–42.

<sup>21</sup> See in general eg JH Baker, *An Introduction to English Legal History*, 4th edn (London: Butterworths, 2002) at 363–64 (hereafter: Baker, *Introduction*).

<sup>22</sup> *Anon* (1368) Y.B. Pasch. 41 Ed. III, f.10, pl. 5, Fifoot, above n 15 at 285.

<sup>23</sup> *Ibid*.



had not made the assurance by that day, the plaintiff brought a writ of Account. Arguing for the defendant, Cavendish denied a receiver status, and thought that the proper Action should have been Debt.<sup>24</sup> Belknap, for the plaintiff, responded that '[w]e cannot have a writ of Debt, for there is no contract on which we can count'.<sup>25</sup> Thorpe CJ conceded that the plaintiff might have brought Debt, but nevertheless allowed Account: 'Inasmuch as he may have an action of Debt or an action of Account, he may choose which of them to bring. Wherefore, albeit he may have a writ of Debt, this will not oust him from the action of Account.'<sup>26</sup>

The bailee's Account liability should be looked upon as part of the expansion of the receiver category,<sup>27</sup> by which Account was ultimately transformed into a general quasi-contract remedy.<sup>28</sup> Nevertheless, Account was a cumbersome proceeding. In general, a judgment in Account established the defendant's accountability and provided for the appointment of auditors to work out its detail. To enforce the auditors' award, the plaintiff was then required to bring a separate and subsequent Debt action.<sup>29</sup> Where the amount in which a defendant was 'accountable' to the plaintiff was in a sum certain and did not require any calculation, as was the case in the bailment of money,<sup>30</sup> such lengthy proceedings served no useful purpose. Courts were hard pressed to avoid the duplication and redundancy of the remedies, and permitted the bailor to sue the bailee directly in Debt.<sup>31</sup> The fact that wager of law<sup>32</sup> could more easily be defeated in Account than in Debt<sup>33</sup> did not reverse this trend.

The disadvantages of Account may explain the pressure to introduce Debt as a cause of action available to the bailor against the bailee.<sup>34</sup> However, Debt did not supersede Account altogether. The ambiguity in relation to the application of these two forms of action to the bailment of money can be seen in connection with the nature of the liability of a custodian of money for safekeeping,

<sup>24</sup> *Ibid.* Perhaps he had in mind the 1294 case cited in n 20 above. It is more likely that he made this argument in order to oust the plaintiff's case from court. Insofar as medieval procedure did not allow for alternative counts, the dismissal of Account would have forced the plaintiff to bring a fresh Debt action where he was required to start all over again, and where the defendant was free to raise all objections, including as to the propriety of the writ.

<sup>25</sup> Above n 22. Compare with text and n 20 above.

<sup>26</sup> Above n 22.

<sup>27</sup> The categories of accountants are enumerated in text and n 21 above.

<sup>28</sup> For this process, see in general, eg Baker, *Introduction*, above n 21 at 363–64, and in greater detail, SJ Stoljar, 'The Transformations of Account' (1964) 80 *LQR* 203 (hereafter: Stoljar, 'Account').

<sup>29</sup> See eg Fifoot, above n 15 at 273–74.

<sup>30</sup> According to Jackson, above n 2 at 26, '[t]here is good reason to think that . . . the [bailor's] remedy was limited to the recovery of the sum paid to [the bailee].' For YearBook authorities, see Baker: *Introduction*, above n 21 at 365, fn 16.

<sup>31</sup> Baker, *Introduction*, *ibid* at 365.

<sup>32</sup> 'Wager of law' is interchangeable with 'compurgation' or 'trial by oath'. It is a method of proof in which a person defends against a claim by swearing that the claim is groundless, and by enlisting others – frequently 11 – individuals ('compurgators') to swear to his (the defendant's) credibility. See eg BA Garner (ed in chief), *Black's Law Dictionary*, 9th edn (St Paul MN: West, 2009) at 1716–17 (v. 'wager of law') and 327 (v. 'compurgation').

<sup>33</sup> For this point, see Fifoot, above n 15 at 273.

<sup>34</sup> The doctrinal explanations are set out in text around nn 84–86 below.

which 'was never really settled in medieval law.'<sup>35</sup> A custodian who failed to return on demand a sum of money delivered to him 'not in a sealed container' in order that it would 'be safely guarded and returned on request' could be held liable either in Account or Debt.<sup>36</sup> Thus, in the course of the fifteenth century, Account was brought in one case involving the bailment of money to be re-bailed at the bailor's request.<sup>37</sup> Another case specifically approved of the availability of either Debt or Account in connection with the bailment of money not in a sealed bag.<sup>38</sup> In a third case Littleton CJP stated that 'where one bails a certain sum of money . . . , if it be in a bag, or in a box, he will have an action of Detinue, and otherwise . . . he will have an action of Debt'.<sup>39</sup> In a fourth case, the delivery of money for safekeeping was said to trigger either Detinue or Debt, presumably depending on whether or not money had been delivered in a sealed bag.<sup>40</sup>

Thus, a firm line of demarcation was drawn between two categories of cases involving the liability of one to whom money was delivered. For cases covered in the first category either Account or Debt was available. For the second category recovery could be made in Detinue. The first category is typified by *Core's Case* (1537),<sup>41</sup> where money was delivered to the bailee to purchase merchandise for the bailor. Upon the bailee's death prior to the purchase, the bailor sought to recover the money. In that and other cases of the first category, the bailee 'had liberty by the bailment to make an exchange' of the money delivered to him.<sup>42</sup> Consequently, liability was in terms of the sum of money, not the coins themselves, and hence in Debt or Account. This was true even where the money delivered to the bailee was 'sealed up in a bag', provided of course that the bailee was free to open the bag and use the money, and was liable to the bailor only in terms of its amount.<sup>43</sup>

Usually, however, delivery of money sealed up in a bag fell into the second category of cases. Money in a bag which the bailee was not free to use, or the bag of money itself,<sup>44</sup> became the subject of a Detinue action 'to recover the thing it self'.<sup>45</sup> The Detinue category also covered cases involving 'money that

<sup>35</sup> Simpson, above n 2 at 183, citing at fn 1, YearBook authorities addressed immediately below.

<sup>36</sup> Simpson, *ibid* at 183.

<sup>37</sup> *Cheney v Alisand, executor of J Flint* (1425) 4 Hen. VI, M.f. 2, pl. 4, available online: [www.bu.edu/phpbin/lawyearbooks/display.php?id=17001](http://www.bu.edu/phpbin/lawyearbooks/display.php?id=17001).

<sup>38</sup> (1439) 18 Hen. VI, M.f. 20, pl. 5, available online: [www.bu.edu/phpbin/lawyearbooks/display.php?id=17818](http://www.bu.edu/phpbin/lawyearbooks/display.php?id=17818).

<sup>39</sup> (1467) 6 Edw. IV, H.f. 61, pl. 6, available online: [www.bu.edu/phpbin/lawyearbooks/display.php?id=19890](http://www.bu.edu/phpbin/lawyearbooks/display.php?id=19890).

<sup>40</sup> (1484) 2 Ric. III, M.f. 14, pl. 39, available online: [www.bu.edu/phpbin/lawyearbooks/display.php?id=21105](http://www.bu.edu/phpbin/lawyearbooks/display.php?id=21105).

<sup>41</sup> Dyer, 20a, 73 E.R. 42, Fifoot, above n 15 at 285.

<sup>42</sup> *Ibid* at 22a (Dyer), 46 (E.R.), 287 (Fifoot).

<sup>43</sup> See eg *Anon* (1573) 3 Leon 38, 74 E.R. 526 (money sealed in a bag given to the bailee to be used by him to purchase goods for the bailor).

<sup>44</sup> See paragraph containing n 16 above.

<sup>45</sup> *Sir George Walgraces Case* (1606) Noy 12, 74 E.R. 983.

may be known',<sup>46</sup> namely coins 'valued for their rareness or their aesthetic or archaeological interest'<sup>47</sup> and not used as current money. The second category thus encompassed cases where a bag of money or coins was treated as specific goods.<sup>48</sup> Strictly speaking, only the first category, where liability lay in terms of the sum of money and not any specific chattel,<sup>49</sup> involved the bailment of money.<sup>50</sup> It was to be contrasted with the bailment of a bag of money or specific coins, falling under the second category.<sup>51</sup>

Responsibility for the loss or theft of money varied and depended on whether liability was to return money lent (in Debt), to account for money delivered (in Account), or to return a specific chattel (in Detinue).<sup>52</sup> Responsibility in Debt was absolute, and was not excused by lack of negligence or even *force majeure*.<sup>53</sup> Whether any defence could be raised in Account was not settled.<sup>54</sup> In Detinue, originally, as in Debt, no defence was available to a defendant.<sup>55</sup> Subsequently, however, following the treatment of the liability under deposit in Roman law,<sup>56</sup> a custodian who was sued in Detinue could raise a defence based on his due diligence or lack of any fault.<sup>57</sup> However, in the course of the fifteenth century, the defence disappeared and responsibility tightened. It became excused only when two cumulative conditions existed. Loss must thus have occurred, first, in circumstances beyond the custodian's control. Second, the loss must have occurred in circumstances in which no cause of action or remedy, even theoretical, existed against the wrongdoer.<sup>58</sup> Ultimately, as the seventeenth century came to an

<sup>46</sup> See eg *Bretton v Barnet* (1599) Owen 87, 74 E.R. 918.

<sup>47</sup> For this definition of coins which are not treated as fungible chattels, see FH Lawson and B Rudden, *The Law of Property*, 3rd edn (Oxford: Oxford University Press, 2002) at 27.

<sup>48</sup> See text around nn 15–16 above.

<sup>49</sup> See text around n 42 above.

<sup>50</sup> As defined in text and n 17 above.

<sup>51</sup> See text around n 16 above.

<sup>52</sup> In Detinue, this development is best outlined by Milsom, above n 15 at 266–69.

<sup>53</sup> Though in the late thirteenth century, 'Britton, knowing no Roman law and misunderstanding Bracton's point' on the liability of the custodian for safekeeping discussed below, thought that an accidental loss would excuse a money debtor. Milsom, *ibid* at 267.

<sup>54</sup> For a non-conclusive discussion on the point see Hil. 38 Eliz. (1596), Owen 57, 74 E.R. 897, where it was debated whether as in Detinue (see immediately below), a plea based on loss in circumstances beyond control so as to provide the defendant with a cause of action, even theoretical, against a wrongdoer, cannot be raised before the auditors.

<sup>55</sup> This view, attributable to Glanvill at the beginning of the thirteenth century, may be explained on the basis of the common ancestry of Debt and Detinue. See Milsom, above n 15 at 267.

<sup>56</sup> For the limited liability under Roman law of a depositary of a chattel for safekeeping, effectively, only for a wrongful intentional act or gross negligence, see above, ch 5, section 2, text around n 19.

<sup>57</sup> This was Bracton's position in the middle of the thirteenth century, which subsisted through the fourteenth century as well. See Milsom, above n 15 at 267–68, and Fifoot above n 15 at 159–60.

<sup>58</sup> This is following *The Case of the Marshalsea* (1455) Y.B. Hil. 33 Hen. 6, f. 1. pl. 3, Fifoot, *ibid*. at 168, where the Court, which dealt with the liability of the Marshal of the King's Bench upon the escape of a prisoner, was prepared to accept a plea based on loss caused by 'the King's enemies or . . . sudden tempest' but not by an act of any of the King's subjects, including an unknown King's subject, against whom the Marshal had an action. See also *Southcote v Bennet* (1601) Croke, Eliz. 815, 78 E.R. 1041; 4 Co. Rep. 83b, 76 E.R. 1061, Fifoot, *ibid* at 169.

end, with Detinue having partly been superseded by the action on the Case, the custodian's responsibility was re-linked to due diligence or duty of care.<sup>59</sup>

The delivery of money by one person ('bailor') to another ('bailee') to deliver to a third person ('beneficiary') is a specific type of 'bailment of money'.<sup>60</sup> In such a case, the delivery of money to the beneficiary is the particular purpose to be carried out by the bailee. It is unlikely that the bailment of money was associated in Medieval England with 'banking', namely, the deposit of money to be lent by the depositary in his own name. Nevertheless, it is not all that clear that the bailment of money precluded the bailee from borrowing the money or some of it until repayment.<sup>61</sup> Regardless, it seems obvious that the bailment of money did not require the bailee to deliver to the beneficiary the same coins originally delivered to him by the bailor.<sup>62</sup> Otherwise, the bailee's liability to the bailor would have been in Detinue.<sup>63</sup> In the final analysis, the bailment of money is the delivery of money by one person to another for safekeeping, whether as an end in itself, or pending the use of the money for some other purpose. Such purpose may be the subsequent delivery of the money to a beneficiary, possibly in payment of a debt owed to him by the bailor. Either way, under the bailment of money, delivery of the money is in circumstances under which the bailee is free to mix the money with his own (or with that of other bailors), so as to be liable to return the specific sum, but not necessarily the specific coins.

In fact, the bailment of money to be delivered to a beneficiary is the bailment of money for safekeeping with the additional purpose of the delivery to the beneficiary, whether with or without a demand made by him.<sup>64</sup> Under these circumstances, liability in Detinue was out of the question. At the same time, as in connection with the bailee's liability for the safekeeping of money delivered to him other than in a sealed bag, no clear determination was made between Account and Debt.

Two prominent *dicta*<sup>65</sup> came to support the proposition that a bailee who has failed to deliver the money to the beneficiary is chargeable to the bailor, not only in Account, but also in Debt. First, in *Doige's Case* (1442),<sup>66</sup> Newton CJ<sup>67</sup> stated that

<sup>59</sup> A leading case, in which Holt CJ explicitly followed Roman law, is *Coggs v Bernard* (1703) 2 Ld. Raym. 909, 92 E.R. 107, Fifoot, *ibid* at 173.

<sup>60</sup> See in general, Jackson, above n 2 at 24. 'Bailment of money' is defined in text and n 17 above.

<sup>61</sup> Notwithstanding Simpson, above n 2 at 184, who suggests that as 'a mere intermediary' the bailee 'is not to have the use of the money' and goes on to say that the intermediary is to pass the specific bailed coins to the beneficiary. Simpson's view as to the beneficiary's property in the specific coins delivered by the bailor to the bailee is criticized in n 177 below.

<sup>62</sup> Notwithstanding D Fox, *Property Rights in Money* (Oxford: Oxford University Press, 2008) at 83–84, fn 57, whom I understand to say that the bailee was not allowed to mix the bailor's money but was required to keep it separately.

<sup>63</sup> See text and nn 17–19 above.

<sup>64</sup> In fact this possible element, that of demand by the beneficiary, has not been discussed, and whether in a given case it existed or not is not clear.

<sup>65</sup> Other yearbook authorities are cited by Ames, above n 2 at 120, fn 4.

<sup>66</sup> Y.B. Trin. 20 Hen. 6, f. 34, pl. 4, Fifoot, above n 15 at 347.

<sup>67</sup> But note that a year earlier, Newton CJ thought that only Account was available. *Anon* (1441) Y.B. 19 Hen. VI, 5, pl. 10. See Jackson, above n 2 at 25, fn 1; and Ames, above n 2 at 120, fn 3.

‘[i]f I bail a certain sum of money to *Paston* to bail over to *Fortescue*, now, if *Paston* does not do this, he will be liable to me in an action of Account and also in an action of Debt’.<sup>68</sup> As to the relationship between these two liabilities, the plaintiff-bailor may choose which action to bring, and having ‘brought the one, the other is extinguished’.<sup>69</sup> Second, in a 1505 Anonymous case,<sup>70</sup> Frowicke CJ stated that ‘if I bail money to one to bail over and he converts it to his own use, I can have action of Account [or] Debt’.<sup>71</sup> Also, in *Core’s Case* (1537), the majority of the court thought that ‘if money be delivered . . . to be bailed over, if the bailee break his trust, [Debt or Account] lies for the bailor’.<sup>72</sup> Indeed, the bailee’s liability to the bailor in Debt or Account, arising upon the bailee’s failure to hand over the money to the beneficiary, is in line with the 1368 *Anonymous* case.<sup>73</sup> As will be recalled, this case held in general for the bailee’s liability to the bailor in Debt or Account upon the bailee’s failure to carry out the particular purpose.<sup>74</sup> The failure to deliver the money to the beneficiary is just one instance of such a bailee’s failure.<sup>75</sup>

The availability of Debt against a custodian of money for safekeeping who was not required to keep it segregated was settled in *Bretton v Barnet* (1599).<sup>76</sup> The case dealt with the situation where ‘[a] man delivers money to J.S. to be redelivered to him when he should be required: which J. S. refused’.<sup>77</sup> The plaintiff-bailor brought a Debt action against JS. Particular emphasis was given in the judgment to the distinction between Debt and Detinue, namely between an action for a sum of money, and an action for the return of specific coins.<sup>78</sup> Explicitly citing a case with similar facts to those of *Core’s case* (1537),<sup>79</sup> the court held for the plaintiff. The judges were not concerned with the question of

<sup>68</sup> Above n 66 at 348, Fifoot.

<sup>69</sup> *Ibid.*

<sup>70</sup> *Anon* (1505) Y.B. Mich. 20 Hen. VII, f. 8, pl. 18, Fifoot, above n 15 at 351 (also reported in Keilway 69 and 77, 72 E.R. 229 and 239 as (1506), and Mich. and Hil. 21 Hen. VII. See Fifoot, *ibid* at 351, fn 54).

<sup>71</sup> Fifoot, *ibid* at 352. Frowicke CJ (who was in the minority as to the principal holding of that case) would allow also an action on the Case. Case was introduced to facilitate the bailor’s remedy for consequential loss, or in modern terminology, for wrongful dishonour. *Ibid* at 352, 353. In the Keilway 77 report, *ibid*, the same judge is reported to mention Account and Case only. Debt is surprisingly omitted.

<sup>72</sup> Above n 41 at 22a (Dyer), 46 (E.R.), 287 (Fifoot) per Spilman J, Portman J, and Fitzjames CJ. For opposing counsels’ views, see *ibid* 20a and 20b (Dyer), 43 and 44 (E.R.).

<sup>73</sup> Above n 22. The case is explicitly relied upon by the majority of the Court in *Core’s Case*. *Ibid*.

<sup>74</sup> See text and nn 22–26 above.

<sup>75</sup> See text following n 60 above. According to Ames, above n 2 at 120, the bailor ‘might have account, and afterwards debt’ against the bailee, also where the bailee’s failure to deliver the money was caused by the beneficiary’s refusal to accept it.

<sup>76</sup> Above n 46.

<sup>77</sup> *Ibid*. Notwithstanding the ambiguity in this statement of facts, the report unequivocally suggests (and so it was understood by Simpson, above n 2 at 183) that the case dealt with the deposit of money for safekeeping, and not with a demand loan. It is unlikely that a borrower’s Debt liability would have been disputed in 1599.

<sup>78</sup> See text and nn 15–16 and 34–51 above.

<sup>79</sup> Under the cited judgment, where ‘a man delivers money to another to buy certain things for him, and he does not buy them, the party may bring an action of debt’, above n 76. *Core’s Case* is cited in n 41 above, and the facts of the case are summarized in the text thereafter.

whether the bailee had been free to use the money.<sup>80</sup> Rather, they agreed that ‘if money be delivered, it cannot be known, and therefore the property is altered.’<sup>81</sup> Stated otherwise, the bailee’s freedom to ‘make an exchange’<sup>82</sup> of the money deposited with him, and pay the depositor a sum equivalent thereto, had given adequate grounds for Debt. The case settled once and for all the availability of Debt to a bailor of money delivered other than in a sealed bag. True, it did not overrule the availability of Account, ‘but the point is unimportant since there would be no advantage’ in bringing Account; the latter is appropriate only ‘where there is a need to take accounts to settle precisely what sum can properly be claimed by writ of debt.’<sup>83</sup>

The bailor’s Debt remedy is best explained by an analogy to the remedy of a money lender. Inasmuch as a bailee of money is free to use the specific coins and his liability is in terms of the sum of money delivered to him,<sup>84</sup> he is to be treated very much like a borrower. This is true with respect to every bailment of money, whether to be delivered to a third party-beneficiary for safekeeping, or for any other purpose. The money loan has always been a transaction giving rise to Debt.<sup>85</sup> True, unlike a loan, the bailment of money does not necessarily involve an explicit repayment undertaking on the bailee’s part.<sup>86</sup> Also, unlike a loan, the objective of the bailment of money is not to provide the bailee with the use of the money, but rather to carry out a specific purpose. Nevertheless in the final analysis, every bailment of money contains a strong element of a loan. Inasmuch as any bailee actually receives the *specific coins* for his own use and benefit, subject to his accountability for their *specific amount*, his Debt liability to the bailor is in line with a borrower’s Debt liability to his lender.

In allowing the bailor to sue on Debt, English common law bypassed difficulties encountered both in Roman and Talmudic laws. Thus, as we saw, both Roman law<sup>87</sup> and the Talmud<sup>88</sup> started their analysis of the money depositor/bailor’s remedy by viewing the depositary/bailee of money for safekeeping as a custodian of chattels; they thus made him liable to the bailor on a remedy usually available against a bailee for safekeeping for the return of a specific chattel. To bridge between the right to mix money and liability for the return of a specific chattel, Roman law invented the ‘irregular deposit’, so as ultimately to

<sup>80</sup> Compare with text in the paragraph that follows.

<sup>81</sup> Above n 46.

<sup>82</sup> See above, text and n 42, and therearound.

<sup>83</sup> Simpson, n 2 above at 183. For ‘Account’ as involving cumbersome proceedings, see text at nns 26–32 above.

<sup>84</sup> See text around nn 41–42 above.

<sup>85</sup> See text and n 20 above.

<sup>86</sup> Eg, an explicit undertaking to repay, or to ‘bail . . . back’ existed in the 1368 case, above n 22. See text at n 23 above. No repayment undertaking was involved in *Core’s Case*, above n 41, and text which follows.

<sup>87</sup> For a discussion of Roman law on the point, on which the balance of this paragraph draws, see ch 5, section 2 (particularly text as of n 14 to the end of the section).

<sup>88</sup> For a discussion of Talmudic law on the point, on which the balance of this paragraph draws, see ch 7, section 2.1.

fasten on the depositary/bailee liability akin to that of a borrower. For its part, by reference to the liability of a custodian for safekeeping of a specific chattel, Talmudic law tightened liability on a custodian who was allowed to mix the money; it tightened liability even more on a custodian who actually used the deposited money. However, in Talmudic law, it is only the custodian who actually used the money, who became liable as a borrower.

In contrast to both legal systems, and only on the basis of the bailee's right to mix the money, and not necessarily to use it, English common law imposed on the bailee of money Debt liability, as if the bailee was a borrower. This conclusion was reached in English common law without the entanglement with the regime governing the liability of a custodian of a specific chattel, as was the case in both Talmudic and Roman law. Indeed, as against the bailee of money, English common law did not hesitate between Detinue and Debt, viz between a remedy for the recovery of a specific chattel and that for the recovery of a specific sum of money. Rather, English common law hesitated between two remedies for the recovery of monetary claims, viz Account and Debt. On this point it improved on the Talmudic solution; it even went beyond Roman law in bypassing altogether the category of the irregular deposit, and thus facilitated an easy route to the characterization of the bank deposit as a loan.

Indeed, all three legal systems adopted an analysis that endeavoured to characterize the liability of the depositary/bailee of money as closely as possible to that of a borrower. The approach in all three systems did not rely on the power and right of the depositary to use or lend the deposited money to third parties, namely, to act as a banker. However, their respective analysis impacted on the possibility of the emergence of a banker from the depositary/bailee. Thus, in formally sticking to a chattel custodian analysis, Talmudic law was unable to transform the money deposit into a loan, and hence to allow the depositary himself to lend and become a banker. For its part, while moving closer to a borrower analysis, Roman law developed the irregular deposit that was premised on mixing without using the money; strictly speaking, Roman law would thus have precluded the lending out of an irregular deposit, that is, the transformation of the depositary into a banker. True, use of the money was allowed in Roman law, albeit not on convincing theoretical grounds. At the same time, the bailee's Debt liability in the common law was analysed on the basis of his power to mix, albeit not to use the money, and yet did not preclude the existence of a power to use it. In hindsight, we see that therein lay the grounds that subsequently facilitated the smooth transformation of the depositary for safekeeping of money into a banker who lends money deposited with him.

### 3. THE BENEFICIARY'S RIGHT TO BAILED FUNDS

Unlike the bailor, the beneficiary is not placed in a position similar to that of a lender. Therefore, it is not surprising that the issue of whether the beneficiary



could sue the bailee in Debt had not been easily resolved by Medieval common law. Originally, even the beneficiary's right to bring Account against the bailee was not free from doubts. In 1317, an Account action by a plaintiff-seller failed against a defendant who had been paid by buyers for goods sold to them by the plaintiff.<sup>89</sup> According to that decision, in order to 'bind' the defendant in Account, it was not sufficient for the writ to state that the defendant was a 'receiver of money'. To succeed, the plaintiff must have counted that the defendant was his 'common receiver',<sup>90</sup> presumably on the basis of a pre-existing relationship between them.<sup>91</sup>

It is however arguable that in that case the sale itself was not conducted by the defendant. Had the goods been entrusted to the defendant by the plaintiff-owner by way of trade, the defendant's accountability as a receiver for the proceeds of their sale could not have been disputed.<sup>92</sup> In fact, it is likely that the goods had not been in the defendant's possession at all. Thus, it was convincingly argued in a 1308 case in connection with land lawfully held by the defendant that in general, and without necessarily being 'privy' to the plaintiff-owner, 'he who had the profit of the land ought by law to be charged with the account.'<sup>93</sup> It is hard to see why this does not equally apply to the plaintiff-owner's goods if held by the defendant.<sup>94</sup> It is thus reasonable to assume that the defendant in the 1317 judgment was a messenger<sup>95</sup> with money to be transmitted to the plaintiff-seller. Nevertheless, the report is silent even as to whether the buyer expressly authorized the defendant to hand over the money to the plaintiff. Also, the plaintiff apparently did not authorize the buyers to pay the defendant; this is so since according to the defendant, the plaintiff had not lost his cause of action against the buyers.<sup>96</sup>

On its facts, the 1317 case could perhaps thus be narrowly understood to mean only that a bailee who was neither expressly instructed by the bailor to pay the beneficiary, nor appointed by the beneficiary, could not be liable to the beneficiary in Account. Furthermore, under no circumstances could the bailee's consent to owe to the beneficiary be bypassed; conferring on the beneficiary a direct remedy against a bailee, without the latter's agreement, would be tantamount to the assignment to the beneficiary of the debt owed by the bailee to the bailor which, as indicated in section 1 above, was impossible in the common law.

<sup>89</sup> *Anon* (1317–18) Y.B. 11 Ed. II, reprinted in (1942; reprint 1996) 61 Selden Soc. 264.

<sup>90</sup> *Ibid.*

<sup>91</sup> See eg Stoljar, 'Account', above n 28 at 209.

<sup>92</sup> *Anon* (1309) Y.B. 2 & 3 Ed. II, reprinted in (1904) 19 Selden Soc. 34; *Pirton v Tumby* (1315) Y.B. 8 Ed. II, reprinted in (1924) 41 Selden Soc. 59, Fifoot, above n 15 at 280. See in general Fifoot, *ibid* at 271.

<sup>93</sup> *Anon* (1308) Y.B. 1 & 2 Ed. II, reprinted in (1903) 17 Selden Soc. 107 at 108, Fifoot, above n 15 at 271–72. See also Stoljar, 'Account', above n 28 at 208–09.

<sup>94</sup> The distinction between a bailiff of land and a receiver of merchandise, discussed by Fifoot, above n 15 at 271, does not appear to be relevant.

<sup>95</sup> For this term, see eg MS Arnold (ed for The Ames Foundation), Y.B. 2 Rich. II, 1378–1379, Introduction xxvi (1975). See also n 100 below.

<sup>96</sup> Above n 89.

Half a century later, in 1368, the 1317 judgment was not perceived as an obstacle to the bailee's accountability to the beneficiary, where the bailee had been instructed by the bailor to hand over the money to the beneficiary. An argument in the above-mentioned 1368 case<sup>97</sup> conceded the beneficiary's Account remedy, but rejected altogether his right to bring an action in Debt. Thus, arguing for the defendant, Cavendish asserted that '[i]f I bail certain money to you to bail to one John, he will have a writ of Account . . . and he cannot have an action by a writ of Debt.'<sup>98</sup> The same view was confirmed by Belknap CJ and 'conceded by everyone' in *Hastynge v Beverley* (1379):<sup>99</sup> 'If I am debtor to Percy, J., in the amount of one hundred pounds and bail the money to John Holt to pay him the money, if John Holt does not pay it to him he will have an action of account and no other action'.<sup>100</sup> While neither case mentions the bailee's consent, such consent must be taken to exist.

A 1306 authority<sup>101</sup> cited by Holdsworth<sup>102</sup> to support the availability of Debt as an alternative remedy in the beneficiary's hands, is disputed by Jackson, who points out that in that case, 'the beneficiary was not suing.'<sup>103</sup> In fact, this was an action by an executor for 'silver' (money?) delivered to the use of a person who died possibly under the age of majority. However, the report is cryptic; it turned more on questions of the age of majority according to custom, the effect on the plaintiff's right of the death of his co-executor who had been served with the writ, and the executor's right to bring the action, assuming the deceased had such a right. It is not even clear from the report whether the plaintiffs were executors of the beneficiary (whom we know to be dead) or the bailor(s) (who may or may not be dead). The report does not contain any discussion which sheds light on the availability of the Debt remedy to the beneficiary.

It is actually widely agreed that an argument in a 1458 decision<sup>104</sup> is stronger evidence for the beneficiary's alternative Debt remedy.<sup>105</sup> At first blush, the

<sup>97</sup> Above n 22.

<sup>98</sup> *Ibid.*

<sup>99</sup> (1378–79) Y.B. 2 Rich. II, reprinted in Arnold, above n 95 at 122–23. Another report of the case (Fitz Abr. Accompt. pl. 45) is fully translated by Hening, above n 2 at 347–48.

<sup>100</sup> *Ibid* at 122–23 (Ames Foundation). In that particular case, the defendant claimed that he was merely a 'messenger'. According to Arnold, above n 95, the term 'messenger' denoted an association with a business concern offering professional courier services. Perhaps as such he was to be treated as a custodian of money for safekeeping throughout transit. While not liable to deliver to the beneficiary the same coins given to him by the bailor, he himself might not be free to have the use of them. This may explain the doubts as to the beneficiary's rights to bring Debt. Compare with n 85 above and text around it. Perhaps this particular set of facts, involving the liability for money held by a messenger, affected the generality of the proposition in the accompanying text.

<sup>101</sup> *Anon* (1305–07) Y.B. 33–35 Edw. I (R.S.), 238 (which can be visited online at [www.bu.edu/phpbin/lawyearbooks/display.php?id=1964](http://www.bu.edu/phpbin/lawyearbooks/display.php?id=1964)).

<sup>102</sup> W Holdsworth, *A History of English Law*, 5th edn (London: Methuen, Sweet & Maxwell, 1942, reprint 1966) vol III at 426, fn1.

<sup>103</sup> Jackson, above n 2 at 31, fn 2.

<sup>104</sup> *Anon* (1458) Y.B. 36 Hen. VI, f. 9, pl. 5.

<sup>105</sup> Relying on this report, Holdsworth concluded that the principle governing the beneficiary's right to bring Debt 'was certainly established in the reign of Henry VI'. vol III, above n 102 at 426. According to Jackson, compared to the 1306 authority (see text and nn 101–03 above), the argument

argument is indeed quite convincing: 'when a man pays to another certain money by my commandment to my [benefit,] if he who receives this money is unwilling to pay me, I shall have a good writ of debt or account against him'.<sup>106</sup> Nevertheless, as Simpson pointed out,<sup>107</sup> the argument deals only with the case where payment by the bailor was made to the bailee at the beneficiary's command and direction. Only under such narrow circumstances may the beneficiary elect between Account and Debt.

A statement made by Brian CJ in a 1479 *Anonymous* case<sup>108</sup> explicitly rejects the availability of Debt as an alternative remedy in the beneficiary's hands.<sup>109</sup> It was argued in that case that 'if I deliver £20 to *Catesby* to deliver to *Pigot*, he can have either a writ of Account against *Catesby* or a writ of Debt.'<sup>110</sup> Brian CJ rejected this proposition quite decisively: 'he shall have an action of Account and not of Debt. For on what matter shall his action of Debt be founded? He cannot declare on a contract, as on a sale or on a loan, and so such an action must fail.'<sup>111</sup> The same objection that had originally impeded the availability of Debt in the bailor's hands<sup>112</sup> thus reappeared and presented an obstacle to the availability of Debt to the beneficiary.

Further opposition to the beneficiary's alternative Debt remedy came from Frowicke CJ in a 1506 *Anonymous* case:<sup>113</sup> 'The stranger', that is, the beneficiary, 'has no other remedy except an action of Account.'<sup>114</sup> Likewise, according to one report of *Core v May* (1536–37),<sup>115</sup> the beneficiary may not sue the bailee in Debt but only in Account, since the money 'was never' the beneficiary's and 'he was not privy to the contract.'<sup>116</sup>

Ames<sup>117</sup> cites a 1528 judgment<sup>118</sup> as the first case in which Debt was allowed between the beneficiary and the bailee. The decision is nevertheless quite vague.

in the 1458 case 'is much stronger evidence' of the beneficiary's Debt remedy. Above n 2 at 31, fn2. According to Hening, the argument indicates that 'the old distinction between debt and account to enforce [the beneficiary's] right was becoming obliterated.' Above n 2 at 349.

<sup>106</sup> The translation is from Hening, *ibid* at 349. The original language is reproduced in Holdsworth, vol III, *ibid* at 426, fn 2.

<sup>107</sup> Simpson, above n 2 at 184, fn 3.

<sup>108</sup> *Anon* (1479) Y.B. Hil. 18 Ed. 4, f. 23, pl. 5, Fifoot, above n 15 at 113.

<sup>109</sup> Jackson cites the case, erroneously in my opinion, as an authority for the proposition that the bailor could not sue the bailee in Debt. Jackson, above n 2 at 25, fn 1.

<sup>110</sup> Fifoot, above n 15 at 113.

<sup>111</sup> *Ibid* at 113–14. See Hening, above n 2 at 349–50.

<sup>112</sup> See text and n 20 above.

<sup>113</sup> Keilway 77, 72 E.R. 239. See n 70 above.

<sup>114</sup> *Ibid*.

<sup>115</sup> (1537) Spel. Rep. Vol I, reprinted in (1976) 93 Selden Soc. 132. The other report is cited in n 41 above.

<sup>116</sup> *Ibid*. According to the Dyer report, Luke J (dissenting) alone stated that the beneficiary may bring Account only. His reasoning: 'no action of debt lies without a contract'. Above n 41 at 21b (Dyer), 45 (E.R.). Compare with text around nn 110–12 above. The Dyer report does not record the majority view on this point.

<sup>117</sup> Ames, above n 2 at 119 and fn1.

<sup>118</sup> *Anon* (1528) Y.B. 19 Hen. VIII, f. 3, pl. 15.

Thereunder, one may bring 'Debt on contract by another hand',<sup>119</sup> but the circumstances under which the plaintiff-beneficiary obtains this right are not set out. In fact, the actual case involved Detinue by 'bailment of certain goods by another hand'<sup>120</sup> and was primarily concerned with the beneficiary's right to bring Detinue.<sup>121</sup> It held that the defendant in such a Detinue action, like the defendant in the beneficiary's Debt action, but unlike the defendant in Account who alleges receipt from a third party, may wage his law.<sup>122</sup> If the Debt illustration is concerned with the bailment of money, the report undoubtedly reflects an acknowledgment of the beneficiary's Debt remedy.

There is strong, though not infallible, evidence that in the second half of the sixteenth century, Debt was considered a viable remedy. Thus, it is said in Brooke's *Abridgement*,<sup>123</sup> in connection with the bailment of money, that either Account or Debt is available to the beneficiary against the bailee.<sup>124</sup> Nevertheless, Brooke relied solely on the argument in the 1458 decision,<sup>125</sup> and overlooked any opinion to the contrary.<sup>126</sup> Furthermore, in another place, the same *Abridgement*<sup>127</sup> is quite hesitant in stating that Debt is available to the beneficiary against the bailee as an alternative to Account.<sup>128</sup>

The beneficiary's right to sue in Debt was finally and authoritatively established, though not without reservation, at the turn of the seventeenth century.<sup>129</sup> *Shaw v Norwood* (1600)<sup>130</sup> is often cited<sup>131</sup> as an early successful Debt action on behalf of a beneficiary.<sup>132</sup> But in that case, receipt of the money for the

<sup>119</sup> In the original: '*Det sur contract per auter main*'.

<sup>120</sup> In the original: '*bail[ment] de certains biens per autre main*'.

<sup>121</sup> For bailment of goods to the benefit of a third party, and for the third party-beneficiary's action against the bailee in Detinue, see: *Anon* (1339) Y.B. 12 & 13 Ed. III (R.S.), 245. For wage of law, see n 32 above.

<sup>122</sup> For this proposition, see Fifoot, above n 15 at 273. Compare with text and nn 32–33 above.

<sup>123</sup> R Brooke, *La Graunde Abridgement* (London: Richardi Tottell, 1576). Sir Robert Brooke, who was the Chief Justice of the Common Pleas between 1554–1558, died in 1558. According to PH Winfield, *The Chief Sources of English Legal History* (Cambridge, Mass: Harvard University Press, 1925) at 233, his *Abridgement* was published in 1568, and reappeared in 1570, 1573, 1576 and 1586.

<sup>124</sup> Dette, Pl. 130, or according to Hening, above n 2 at 351, Dette 129 in the 1573 edition. (Also Jackson, above n 2 at 31, fn 6, cites Dette, Pl. 129). 'Debt by Wange & Bittinge where 10 pounds is paid to W.N. to my use I shall have action of debt or of account against W.N. and this agrees with an old book of entries of pleas.' Translation is taken from Hening, *ibid* at 351, fn 3.

<sup>125</sup> Above n 104. See text and nn 104–06 above.

<sup>126</sup> See text and nn 108–16 above.

<sup>127</sup> Above n 123, Accompt, pl. 61.

<sup>128</sup> In a statement similar to that translated in n 124 above, the availability of Debt is qualified by 'query'. See Jackson, above n 2 at 31, fn 3.

<sup>129</sup> According to Hening, above n 2 at 351, '[l]ong prior to 1573 the alternative remedy of the beneficiary by writ of debt was clearly established.' It follows from the previous discussion that this is an exaggeration.

<sup>130</sup> *Moore* (K.B.) 667, 72 E.R. 827.

<sup>131</sup> See eg Baker, *Introduction*, above n 21 at 365, fn 20.

<sup>132</sup> Specifically, this was an action by the administrator of one of the two beneficiaries against the bailee's executor. The court held that he could sue either in Debt or in Account, at his election, and upheld the Debt action.

beneficiaries' use was acknowledged by a sealed document.<sup>133</sup> The first decision in favour of a beneficiary where no sealed document is mentioned is *Clark's Case* (1614).<sup>134</sup> In a short judgment 'it was said by Cook, Chief Justice, and agreed by the whole Court . . . that if a man deliver money unto I.S. to my use, . . . I may have an action of debt, or account against him for the same, at my election.'<sup>135</sup> An important qualification was subsequently pronounced in *Harris v De Bervoir* (1624).<sup>136</sup> Debt will lie only where the money delivered to the bailee 'is intended in satisfaction of a debt' owed by the bailor to the beneficiary so that 'it is not countermandable'. Only then, 'he who is to receive it as a debt, [namely the beneficiary] may upon this receipt [by the bailee] have an action [against the bailee] of debt or account.'<sup>137</sup> Otherwise, the beneficiary may bring 'account only'.<sup>138</sup> Bailment of money designed to be paid over by the bailee to the beneficiary, in discharge of a debt owed by the bailor to the beneficiary, was thus singled out as the only situation where Debt may be brought by the beneficiary against the bailee as an alternative to the Account.<sup>139</sup>

The final clarification or expansion<sup>140</sup> took place towards the end of the eighteenth century, after *Indebitatus Assumpsit* had taken over Debt and parts of Account.<sup>141</sup> Thus, *Israel v Douglas* (1789)<sup>142</sup> allowed the beneficiary to recover in *Indebitatus Assumpsit* from a bailee who, having held the bailor's money, was instructed by the bailor to pay it to the beneficiary. The court did not find any meaningful distinction between that case and the 'usual' case of the bailment of money, under which the bailor gives the bailee money to be paid to the beneficiary. It did not matter to the court under what original arrangement the bailor's money had been held by the bailee in the first place. Stated otherwise, assent by the bailee to pay the beneficiary is in any event required even in the usual case of money bailed for the purpose of such payment;<sup>143</sup> hence, there is no difference

<sup>133</sup> Above n 130. See text around n 20 above. Nonetheless, in that case, the sealed document only evidenced the receipt of money, in which case Debt might have been brought on the facts. See in general, Jackson, above n 2 at 22. Also, *quaere* whether under the orthodox rule a third party beneficiary (as opposed to the promisee) could bring Debt on a sealed document.

<sup>134</sup> Godb. 210, 78 E.R. 128.

<sup>135</sup> *Ibid.* See also *dicta* in *Whorewood v Shaw* (1602) Yelv. 25, 80 E.R. 18: 'although no contract is between the parties, yet when money or goods are deliver'd upon consideration to the use of A. A. may have debt for them.'

<sup>136</sup> Cro. Jac. 687, 79 E.R. 596.

<sup>137</sup> *Ibid.*, plaintiff's argument, with which the judges agreed, supports this proposition. Plaintiff's counsel cited the unreported judgment of *Greenwile v Slaninq* (1616), where a successful Debt action was brought by the beneficiary. *Ibid.*

<sup>138</sup> *Ibid.*

<sup>139</sup> Where the money is to be delivered to the beneficiary by way of gift, presumably only Account lies. *Quaere* whether such a distinction is justified. Inasmuch as this chapter is primarily concerned with payment of debts, the distinction and its implications will not be pursued further. For liability in Account for money given 'for the relief of' a third party beneficiary, see *Robsert v Andrews* (1580) Cro. Eliz. 82, 78 E.R. 341.

<sup>140</sup> Ironically, this was the rise before the subsequent fall, discussed at the end of section 5 below.

<sup>141</sup> See the beginning of section 5 below.

<sup>142</sup> 1 H. Bl. 239, 126 E.R. 139.

<sup>143</sup> See text that follows n 96 above.

between the bailee's assent to receive the bailor's money for the use of the beneficiary, as in the 'usual' case, and the bailee's assent to appropriate bailor's money already held by him for the use of the beneficiary, as in the case at bar.

In the final analysis, Medieval authorities point to the lack of privity as the most decisive doctrinal ground underlying the resistance to the beneficiary's Debt remedy.<sup>144</sup> Thus, in the 1368 *Anonymous* case,<sup>145</sup> Cavendish argued for the defendant that, in connection with the bailment of money, Debt lay only where 'at the time of the bailment the property was in him by whom the bailment was made',<sup>146</sup> meaning that only the bailor could bring Debt. Cavendish also argued that the beneficiary 'cannot have an action by a writ of Debt';<sup>147</sup> Fifoot tied this proposition to lack of privity.<sup>148</sup> As well, in 1479 Brian CJ denied the beneficiary's debt remedy on the basis of lack of contract with the bailee,<sup>149</sup> which points at the lack of privity between them.<sup>150</sup> In fact, the 1458 argument allowing Debt,<sup>151</sup> being the only fifteenth-century statement in that direction, was concerned with a situation where the beneficiary instructed the bailor to pay the bailee.<sup>152</sup> Thereby, the beneficiary appointed the bailee so that privity between them was not altogether absent.

Emphasis on privity emerges also from early sixteenth-century reports. Thus, in the 1506 *Anonymous* case,<sup>153</sup> Frowicke CJ explained that the beneficiary may bring Account only, and hence no Debt, since he was a 'stranger'.<sup>154</sup> Likewise, lack of privity is mentioned in the Spelman's report of *Core's Case* (1537)<sup>155</sup> as a rationale for not permitting the beneficiary to sue the bailee in Debt.<sup>156</sup>

In fact, in providing for the beneficiary's Debt remedy,<sup>157</sup> Brooke explicitly acknowledged lack of privity. The Abridgement's marginal note to the rule<sup>158</sup> is, '*Vers estranger sans privitie*',<sup>159</sup> that is, 'Against a stranger without privity'. Lack of privity was thus considered to form the principal objection. The beneficiary's Debt remedy could be conceived by Brooke only in connection with the fall of the walls of privity, or with its dispensation in any event. Ironically, however, the

<sup>144</sup> Notwithstanding Jackson, above n 2 at 31, who downplays the importance of privity in Medieval law relating to this point. Another obstacle, at least in some cases, is discussed in n 100 above.

<sup>145</sup> Above n 22.

<sup>146</sup> *Ibid*, emphasis added.

<sup>147</sup> See above, text at n 98.

<sup>148</sup> Fifoot, above n 15 at 223, fn 34.

<sup>149</sup> See text and nn 115–16 above (*Core's Case*). The 'no contract' objection was raised but dismissed in *Harris v De Bervoir*, above n 136. See also n 135 above (dicta in *Whorewood v Shaw*). For contract in Medieval common law as referring to the receipt of *quid pro quo*, see above text at n 20.

<sup>150</sup> For the action of Debt in situations involving contracts but nevertheless lacking privity, see in general Simpson, above n 2 at 153–60.

<sup>151</sup> Above n 104. See in general, text and nn 104–06 above.

<sup>152</sup> See text around n 106 above.

<sup>153</sup> Above n 113.

<sup>154</sup> *Ibid*. In Account, the walls of privity fell early in the fourteenth century.

<sup>155</sup> Above n 115.

<sup>156</sup> See text and n 116 above.

<sup>157</sup> See text and nn 123–24 above.

<sup>158</sup> Hening's translation of the rule is cited and quoted in n 124 above.

<sup>159</sup> See Jackson, above n 2 at 31, fn 6. In the original, it is spelled '*Vers eträger sās privitie*'.

authority relied upon by him as allowing Debt<sup>160</sup> dealt with a situation involving privity between the beneficiary and the bailee.<sup>161</sup> Nevertheless, it is obvious that in establishing the ground for the beneficiary's remedy against the bailee it was essential to overcome privity requirements.<sup>162</sup>

Undoubtedly, pragmatic considerations were quite instrumental in leading Medieval law to recognize the beneficiary's Debt remedy. Already in 1379,<sup>163</sup> it was 'conceded by everyone' that the bailee is liable to the beneficiary in Account only for 'that same amount of money' bailed to him, even if he, the bailee, 'retains it in his hand for ten years'.<sup>164</sup> Stated otherwise, the amount in which the bailee was accountable to the beneficiary was in a sum certain and did not require any calculation. Not surprisingly, as in connection with the bailor's Debt remedy,<sup>165</sup> the avoidance of redundant lengthy proceedings had been the primary motive impelling the beneficiary to prefer Debt over Account. Professor Hening spoke of 'moral pressure' which 'finally forced the courts to treat a [bailee] as a debtor'.<sup>166</sup>

In terms of legal doctrine, the beneficiary's Debt remedy can be viewed as consistent with property concepts. In general, being derived from writs of Right and related to Detinue,<sup>167</sup> Debt was conceived as 'an action of property',<sup>168</sup> so that 'in contemplation of law what the debtor owes is "representative" of what he has received . . . as if he were called upon to give up the very same thing'.<sup>169</sup> What the creditor owns in Debt is thus a claim to a specific sum of money, representing the benefit conferred upon the debtor.

Indeed, the concurrent property of the bailor and the beneficiary was conceded in the 1368 *Anonymous* case.<sup>170</sup> The case dealt with a bailment of money for a purpose other than the delivery to a beneficiary;<sup>171</sup> it was argued for the defendant by Cavendish that in those circumstances 'property was in him by whom the bailment was made, so that he shall have a writ of Debt'.<sup>172</sup> Indeed, inasmuch as a bailee of a chattel was liable to the bailor in Detinue, a bailee of a specific sum of money must have been held liable to the bailor in Debt.<sup>173</sup>

Unfortunately however, the beneficiary's property in the sum of money bailed to be delivered to him was not universally recognized. Moreover, an acknowledgement of property did not necessarily lead to making Debt available to the

<sup>160</sup> See n 125 and accompanying text above.

<sup>161</sup> See text around nn 107 and 152 above.

<sup>162</sup> But cf Simpson, above n 2 at 184 who submits that 'property' analysis ranked highly in the reasons. But to that end, cf discussion that follows the ensuing paragraph.

<sup>163</sup> *Hastynge v Beverley*, above n 99.

<sup>164</sup> *Ibid* at 123 (Ames Foundation), hypothetical by Belknap CJ. It was assumed in that case that the bailee was not required to put the money in trade for the plaintiff's profit.

<sup>165</sup> See in general, text around nn 27–32 above.

<sup>166</sup> Hening, above n 2 at 351.

<sup>167</sup> See, in general, the first paragraph of section 2 above.

<sup>168</sup> See eg *Edgcomb v Dee* (1670) Vaugh. 89 at 101, 124 E.R. 984 at 990.

<sup>169</sup> AV Levontin, 'Debt and Contract in the Common Law' (1966), 1 *Israel Law Review* 60 at 68–69.

<sup>170</sup> Above n 22.

<sup>171</sup> The case is discussed above, in text at paragraph containing nn 22–26.

<sup>172</sup> Above n 22 at 285 (Fifoot).

<sup>173</sup> See, in general, the beginning of section 2 above.



beneficiary. As for the former, in rejecting the beneficiary's Debt remedy, *Core's Case* (1537)<sup>174</sup> denied altogether the beneficiary's alleged property right.<sup>175</sup> At the same time, as for the latter, as indicated, even an acknowledgement of the beneficiary's property right was not accompanied by an admission as to the availability to him of Debt against the bailee. Thus, in his argument for the defendant in the 1368 *Anonymous* case,<sup>176</sup> Cavendish conceded that a bailment of money 'to you to bail to one John' confers upon John property, or more specifically, that 'the property is in him as soon as you receive [the money] from [the bailor's] hands.' Nevertheless, according to Cavendish, the beneficiary John 'will have a writ of Account . . . and he cannot have an action by a writ of Debt.'<sup>177</sup> Furthermore, those who allowed the beneficiary to bring Debt against the bailee chose not to mention property.<sup>178</sup> Perhaps they were disturbed by the notion of property residing simultaneously with the bailor and the beneficiary,<sup>179</sup> so as to justify the bailee's concurrent liability in Debt to each of them.

However, in fact, this notion of property residing simultaneously with the bailor and the beneficiary is quite consistent with the relativity of personal property under the common law. Where the bailee is sued in Debt by the bailor, the former cannot hold the money and defend the latter's action pleading *jus tertii*, namely that property is in the beneficiary's hands. Likewise, when he is sued in Debt by the beneficiary, the bailee cannot hold the money and invoke the bailor's property.<sup>180</sup> The beneficiary comes ahead of the bailor, who may not countermand.<sup>181</sup> As against the bailor's action, the beneficiary's right is, however, no defence to the defaulting bailee who holds the money.<sup>182</sup>

<sup>174</sup> Above n 115.

<sup>175</sup> See above text at n 116.

<sup>176</sup> Above n 22.

<sup>177</sup> *Ibid.* According to Simpson, Cavendish referred to the beneficiary's property in the specific coins delivered by the bailor to the bailee. Simpson, above n 2 at 184. But, to pursue this reasoning, could the beneficiary not then bring Detinue against the bailee? Compare with n 121 above, and n 179 below. Note however, that the beneficiary's Debt remedy was rejected in the 1368 case (see text and n 98 above), notwithstanding the concession as to his property right. At the same time, in rejecting the beneficiary's Debt remedy, the Spelman's report of *Core's Case*, above n 115, denied altogether the beneficiary's alleged property right. See text and n 116 above.

<sup>178</sup> See eg authorities cited in nn 122, 128, 134, and 136 above.

<sup>179</sup> Unlike in connection with the bailment of money, it was not disputed that the bailment of goods for the benefit of a third party passed title from the bailor to the third-party beneficiary. See Jackson, above n 2 at 30 and fn 4. For that reason, the beneficiary's right to bring Detinue against the bailee of goods (discussed in n 121 above) did not 'compete' with a concurrent right of the bailor, and thus was not controversial.

<sup>180</sup> For a short discussion on relative titles, see Lawson and Rudden, above n 47 at 50–52. See also Fifoot, above n 15 at 112–13.

<sup>181</sup> Where the bailment is countermandable, namely, is not intended in satisfaction of a debt, the bailor may bring Debt against the bailee after countermand, even in the absence of the bailee's refusal to carry out the purpose for which the money was bailed to him. See eg *Core's Case*, above n 41 at 22a (Dyer), 46 (E.R.), and 287 (Fifoot) in connection with money bailed 'to give away in alms.' Under those circumstances, the beneficiary may not bring Debt against the bailee. See n 139 above, and text around it.

<sup>182</sup> Nevertheless it seems that, even when faced with competing demands, the bailee could comply with an ineffective countermand, return the money to the bailor, and avoid liability to the beneficiary. See paragraph containing nn 314–16 below.

It seems then that the emergence of the beneficiary's Debt remedy against the bailee, while thin on direct support in the Medieval cases, is an outcome of pragmatic considerations. It is one aspect of the transformation of Debt from a narrow form of action into a broad legal relationship, underlying an unconditional title to a specific sum of money.<sup>183</sup> Indeed, as a matter of legal doctrine, the beneficiary's Debt right had neither been originally rejected necessarily on the basis of lack of property; nor was it subsequently expressly premised on the existence of property. However, the beneficiary's Debt remedy against the bailee is consistent with property concepts; in the final analysis, these concepts provide the best explanation for it. The irony is, however, that – as pointed out in section 5 below – the process under which Debt was transformed from a writ into a legal relationship, having taken place in the context of *Indebitatus Assumpsit*,<sup>184</sup> was part of the evolution of the law of contract.<sup>185</sup> It is in this context that chains of privity re-appeared, ultimately substantially to restrict the beneficiary's remedy in modern law.<sup>186</sup>

#### 4. THE 'RECEPTION' OF THE BILL OF EXCHANGE – PAYEE'S REMEDY

At the earliest, the bill of exchange, or perhaps more specifically, its predecessor, the letter of payment, 'with an English drawer or an English [drawee/paymaster]' appeared in England at the close of the fourteenth century; its use increased in the course of the fifteenth and sixteenth centuries.<sup>187</sup> As elsewhere in Europe, it originally functioned as a mechanism for the execution of the exchange transaction.<sup>188</sup> While England was thus a latecomer to the European theatre of international trade, it appears to be the first place to employ the inland bill of exchange, used as a payment and credit device for domestic transactions, as of the seventeenth century.<sup>189</sup>

An early detailed English bill of exchange report on record is *Burton v Davy* (1437).<sup>190</sup> This was an action brought by a bearer of a bill of exchange against its drawee. In the facts of the case, one Audley, 'factor and attorney of Elias Davy',<sup>191</sup> drew in Bruges, Flanders, a 'letter of exchange'<sup>192</sup> in the sum of 30 pounds sterling,

<sup>183</sup> This transformation is the subject of Levontin, above n 169.

<sup>184</sup> See text and nn 286–87 below.

<sup>185</sup> The emergence of *Assumpsit* as the remedy for breach of contract is addressed in text and nn 218–22 below.

<sup>186</sup> See in general, text and nn 350–62 below.

<sup>187</sup> MM Postan, 'Private Financial Instruments in Medieval England' (1930), reprinted in MM Postan, *Medieval Trade and Finance* (Cambridge: Cambridge University Press, 1973) at 28, 58.

<sup>188</sup> Postan, *ibid* at 54–64 and JH Munro, 'The Medieval Origins of the Financial Revolution: Usury, Rentes, and Negotiability' (2003), 25 *International History Review* 505 at 542–46.

<sup>189</sup> See ch 8, section 5, text and nn 294–95.

<sup>190</sup> 49 Selden Soc. 3, Select Cases Concerning the Law Merchant (H Hall, ed, London: Bernard Quaritch, 1932) 117.

<sup>191</sup> *Ibid.*

<sup>192</sup> *Ibid.*

on his master, Elias Davy, a merchant of London. The instrument was payable in London to John Burton, merchant of Norwich, or to the bearer of the letter. It appears that Audley in Bruges 'received by way of exchange' (that is, borrowed) from Burton 'by the hands of'<sup>193</sup> Hanworth, 30 pounds used for the purchase of goods from a third party. In return for the credit so extended, Audley drew the instrument and handed it to Hanworth. The goods ('linen cloth and other merchandises') so bought by Audley were to be shipped to England, 'for the need and use'<sup>194</sup> of Davy, Audley's master, who was expected to pay Burton or bearer in England. One may speculate that Davis was expected to pay the 30 pounds out of the proceeds received by him from the sale of the goods. A merchant by the name of Walden, the bearer of the instrument, brought an action 'at the court merchant'<sup>195</sup> held before the mayor of London. The action against the drawee was brought 'in the name of'<sup>196</sup> Burton, the original payee, 'according to the law merchant and custom of the city of London, in such like cases used and approved from a time of which no memory survives.'<sup>197</sup> On this basis, judgment was given ordering drawee Davy to pay payee-Burton or to bearer-Walden.<sup>198</sup>

Beutel treats the case as reflecting 'the complete development of the negotiable bill of exchange.'<sup>199</sup> Holden, however, concedes that this is an exaggeration; in his view the case did not address, as it did not have to address, the transferability of the instrument free of claims and defences, and yet, in Holden's view, the case 'is an important milestone along the road to negotiability'; he argues that the case went quite far in recognizing both the transferability of the instrument by physical delivery, and the independent cause of action of its holder, under the law merchant.<sup>200</sup> More recently, along similar lines, Munro spoke of the case as 'a vital precedent to allow the bearer of a dishonoured bill of exchange to sue . . . for both payment and damages.'<sup>201</sup>

This 'conventional interpretation of *Burton v. Davy*' is, however, effectively challenged by Rogers.<sup>202</sup> First he points out that the judgment required payment

<sup>193</sup> *Ibid* at 118.

<sup>194</sup> *Ibid* at 117.

<sup>195</sup> *Ibid*.

<sup>196</sup> *Ibid*.

<sup>197</sup> *Ibid*. Similar expressions are scattered throughout the entire judgment. Eg, at 118, reference is made 'to the law merchant and the ancient liberties and free customs of the city itself.'

<sup>198</sup> *Ibid* at 119.

<sup>199</sup> FK Beutel, 'The Development of Negotiable Instruments in Early English Law' (1938), 51 *Harvard Law Review* 813 at 831.

<sup>200</sup> JM Holden, *The History of Negotiable Instruments in English Law* (London: University of London: The Athlone Press, 1955, reprint 1993, WM W Gaunt & Sons) at 23–25 (the quoted language is at 25).

<sup>201</sup> Munro, above n 188 at 552.

<sup>202</sup> Rogers, above n 4 at 44–51. The quoted language is at 47. See also SE Sachs, 'Burying *Burton: Burton v. Davy* and the Law of Negotiable Instruments', *Medieval Studies* 117: Constitutional and Legal History of Medieval England, Prof Charles Donahue, Jr, 21 May 2002, online: [www.stevesachs.com/papers/paper\\_burton.html](http://www.stevesachs.com/papers/paper_burton.html). De Roover also disagrees with Beutel's interpretation: R De Roover, *L'Évolution de la Lettre de Change XIVe–XVIIIe Siècles* (Paris: Librairie Armand Colin, 1953) at 111. Otherwise, De Roover does not dispute Holdsworth's 'orthodox' view of the 'reception' of 'Law Merchant' in the common law. *Ibid* at 109.

either to the payee or bearer; this is a far cry from the alleged independent cause of action of the bearer. Second, he points to the detailed discussion of, and the meticulous examination of, evidence designed to prove the underlying transaction; this effectively explains the judgment as enforcing a debt liability on the exchange transaction in Bruges rather than on the bill of exchange issued with respect to it. Indeed, in terms of the earlier analysis in chapter eight of this book,<sup>203</sup> the case appears to involve the early version of the letter of payment, with drawer Audley acting as an agent for drawee Davy, and payee Burton acting as the principal of Hanworth. The transaction was an exchange transaction, in which in relation to the money, Audley, on behalf of Davy, was the taker, and Hanworth, acting for Burton, was the deliverer. In that transaction Davy (through Audley), who procured goods in Flanders for shipment to England, was financed by Burton (acting through Hanworth). What resulted was a debt owed by Davy, albeit contracted by his agent, Audley, to Burton, albeit acting in the transaction through his own agent, Hanworth. Davy's liability was thus not that of a drawee on a bill of exchange, and thus did not require acceptance;<sup>204</sup> rather, it was on a simple debt.<sup>205</sup>

True, this analysis does not resolve the standing and right of bearer Walden and the constant reference in the report to mercantile custom and law merchant. However, and notwithstanding the suggestion of Holden to the contrary, there is no indication whatsoever that the instrument was transferred to Walden 'like cash', so as to confer on him a title thereto.<sup>206</sup> Rather, it is possible that Walden acted for payee Burton of Norwich, possibly as his attorney or collection agent, in London.<sup>207</sup> Arguably, the bearer clause could be nothing more than a power of attorney; indeed, this interpretation is consistent with the final judgment requiring payment to either payee Burton or bearer Walden.<sup>208</sup> Indeed, as explained above in chapter eight, 'bearer' clauses had a checkered history.<sup>209</sup> According to Rogers, the full recognition in the power of such clauses to confer title on the transferee is a development that cannot be traced any earlier than the

<sup>203</sup> See ch 8, sections 3–4 above.

<sup>204</sup> The report does not mention anything re possible acceptance by Davy. Munro's speculation as to the existence of 'acceptance', above n 188 at 552, does not appear to me to be supportable.

<sup>205</sup> Indeed, under Medieval law, the credit purchase of goods by one person to the use of another charged, the latter in Debt. See eg *Randolph v Abbot of Hailes* (1313–14) Eyre of Kent, 6 & 7 Edw. II (1912), 27 Selden Soc. 32 (purchase by a monk for the use of the Abbot of the House); *Anon* (1379) Bellewe 59, 72 E.R. 25 (purchase by a servant to the use of his master); and *Anon* (1379) Bellewe 110, 72 E.R. 47 (purchase by 'my bailiff . . . to my use'). These and other sources are cited and discussed in B Geva, 'Authority of Sale and Privity of Contract: The Propriety Basis of the Right to the Proceeds of Sale at Common Law' (1979), 25 *McGill Law Journal* 32 at 38–49.

<sup>206</sup> Holden, above n 200 at 25. Similar critique holds true with respect to Munro's view, above n 188 at 552, according to which 'Walden's legal role can be explained only by the fact that as the "bearer" holding the bill on maturity, he was its current owner'.

<sup>207</sup> Which is the speculation Sachs, above n 202, is inclined to support.

<sup>208</sup> Moreover, according to Sachs, *ibid*, an earlier record of the proceeding specifically refers to Davy and Burton as the real parties to the litigation.

<sup>209</sup> See above, ch 8, section 5, text around nn 311–12.

seventeenth or even eighteenth century.<sup>210</sup> Their use, and hence even the power to give the bearer the power to collect for the payee, may have been a matter of mercantile practice. In fact, 'common custom of merchants' is used in the report also by reference to the elements of the exchange transaction.<sup>211</sup> In the final analysis, other than for such reasons, it is possible to speculate that the extensive reference to a universal, almost eternal, 'law merchant' may have been made in order to establish a basis for jurisdiction outside to that of common law courts which, as a rule, 'could not properly entertain causes of action arising outside the realm.'<sup>212</sup>

Cases decided in the course of the sixteenth century in the Admiralty Court are said to be not 'as instructive as *Burton v. Davy*',<sup>213</sup> so that in the final analysis, '[t]here is . . . little evidence to suggest that the Admiralty Court developed or applied any special body of law governing bills of exchange.'<sup>214</sup> At most, they dealt with the enforcement of a debt arising from the exchange contract.<sup>215</sup> According to Rogers, debts arising from exchange contracts were enforceable in common law courts so that it is only the territorial limitation, namely, the fact that the involved contracts arose overseas, rather than any substantive limitation, that drove such cases to be decided in either the London's Mayor's Court or the Admiralty Court. Gradually, however, particularly in the course of the sixteenth century, common law courts took over and dealt with the enforcement of debts arising from exchange contracts as a matter of common law.<sup>216</sup>

As in the Continent, in the terminology of chapter eight above, the instrument issued in connection with the exchange transaction was in effect a bill of payment. Not surprisingly, in the latter part of the sixteenth century, while referring to the instrument as a bill of exchange, common law pleadings treated it in the context of the four-party exchange transaction. This meant that the chain of liability was determined not according to relationships on the bill, as analysed in chapter eight, section 4 above, but rather, by reference to the relationships among the parties in the exchange transaction. Thus, the remitter ('deliverer') was a principal, agent, or associate of the payee; in turn, the drawer ('taker') was a principal, agent, or associate of the drawee. Under this scheme, the payee was in privity not only with the remitter, but also with both the drawer

<sup>210</sup> Rogers, above n 4 at 173–77. For the confirmation of this conclusion, as well as to dating final recognition in the present effect of a bearer clause, only to the eighteenth century, see below, ch 11, section 4. But *cf* Munro's discussion, above n 188 at 553–54, as to earlier cases in the Low Countries, decided in the course of the sixteenth century, in the aftermath of *Burton v Davy*, upholding the independent right of the bearer. However, such cases do not necessarily shed light on *Burton v Davy* itself; nor do they eliminate the existence of inconsistency all the way to the period discussed by Rogers.

<sup>211</sup> Above n 190 at 118.

<sup>212</sup> For this limited jurisdiction of the courts of common law, see Baker, *Introduction*, above n 21 at 122.

<sup>213</sup> Holden, above n 200 at 25.

<sup>214</sup> Rogers, above n 4 at 51.

<sup>215</sup> Rogers, *ibid* at 52.

<sup>216</sup> See his detailed discussion, *ibid* at 54–68.

(who promised the remitter to pay upon the failure of the drawee to do so) and the drawee (who was bound by the drawer's undertaking given to the remitter that payment be made to the payee). Thus the payee could sue either the drawer or the drawee. Against each defendant, the payee took the place of the remitter; standing in the remitter's shoes, the payee was in direct privity with the drawer as well as with the drawee, taking the place of the drawer.<sup>217</sup>

All of this took place against a transformation in the common law of contract. As discussed,<sup>218</sup> Debt, the traditional remedy for the recovery of a sum of money, was a variation of a *praecipe* writ, namely a writ of right; as such it was for nonfeasance, or 'not doing', namely, for compelling the defendant to act and perform what he had been under a duty to do.<sup>219</sup> In the course of the 14th century, by reference to the Writ of Trespass, Actions on the Case for the recovery of damages for misfeasance, namely for 'doing wrongly' (as opposed to 'not doing'), became successful and provided remedies in cases of deficient performance of undertakings or duties.<sup>220</sup> Ultimately, in developments whose origins can be traced back to the fifteenth century, having remained theorized on misfeasance, Case gave rise both to the tort of Negligence<sup>221</sup> and to *Assumpsit*, the latter being a remedy for damages for the breach of promise (that is, contract).<sup>222</sup>

Contrary to Debt, *Assumpsit* was not limited to a promise to pay a monetary debt based on either a transaction or a document under seal.<sup>223</sup> More specifically, liability in *Assumpsit* was theorized on damages for the breach of promise by the defendant and not on a sum of money owed by him.<sup>224</sup> Regardless, the principal attraction of *Assumpsit*, like that of Case in general, was simplicity and reliance on a rational trial, thereby avoiding the archaic wager of law procedure.<sup>225</sup> Hence, the sixteenth-century common law pleadings that treated

<sup>217</sup> See Holden, above n 200 at 28–29 as well as Appendices A and B at 324–26. However, Holden treats the agency as 'a fictitious allegation'; in light of the analysis in ch 8, sections 3 and 4 above, this is dubious.

<sup>218</sup> See above in this chapter, at the beginning of section 2.

<sup>219</sup> The same applied to Covenant, which was an action to enforce a formal promise (made on a deed, viz, a sealed document) other than to pay a specific sum of money (the latter being actionable in Debt). For Covenant as such and in general, see eg Baker: *Introduction*, above n 21 at 317–21.

<sup>220</sup> For an extensive discussion, with relevant sources, also discussing various theories as to Case as derivative of, related to, or unrelated to Trespass, see Fifoot, above n 15 at 66–92.

<sup>221</sup> Fifoot, *ibid* at 154–83 (as to origins of Negligence), followed by a subsequent detailed discussion (*ibid* at 184–213) on the emergence of a demarcation line between Trespass and Case. Certainly, as an independent tort, Negligence is a more recent development.

<sup>222</sup> Fifoot, *ibid* at 330–57 (discussing the evolution of *Assumpsit*). Particularly note the discussion on how a claim for damages for non-performance ('nonfeasance') becomes actionable under a theory premised on liability for misfeasance. For *Assumpsit* for nonfeasance see also Baker, *Introduction*, above n 21 at 333–41.

<sup>223</sup> Nor was it limited to any type of promise. In that sense, other than being theorized differently and dispensing with the seal, *Assumpsit* complemented Covenant.

<sup>224</sup> See preceding paragraph above.

<sup>225</sup> See eg Baker, *Introduction*, above n 21 at 341–42. Interestingly, wager of law was allowed though waived in one of the earliest actions in Case. See *The Surgeon's Case* (1375) YB Hil. 48 Ed. 3, f. 6, pl. 11, as reproduced in Fifoot, above n 15 at 82. Denial of the benefit of wager of law (characterized by the defendant as 'his birthright') was not allowed as grounds for the dismissal of

the bill of exchange in the context of the four-party exchange transaction envisaged payee's action, whether against the drawer or against the drawee, to be in *Assumpsit*<sup>226</sup> and not Debt. At the same time, as discussed, having involved the liability for the breach of a promise to pay on an exchange contract, vis-a-vis a party to that contract, these pleadings do not reflect any change to substantive law insofar as it relates to the bill of exchange; rather they reflect the transformation of the theory underlying contract liability in general.<sup>227</sup>

However, as discussed above in chapter eight, section 5, towards the end of the seventeenth century, bill of exchange practice had been transformed; the instrument had come to facilitate the remittance of funds between two places, also domestically, and in any event, in situations unrelated to the performance of an exchange transaction. In the process, remitter and payee became unrelated; instead of principal and agent, they became debtor and creditor. Hence, the procedural accommodation to a new action, as just discussed, did not suffice to underpin liability in a new emerging setting.

To that end,<sup>228</sup> *Chat and Edgar Case* (1663)<sup>229</sup> is quite instructive. In the facts of that case:

[A] butcher having bought cattle of the plaintiff, who was a grasier in Norfolk, came to the defendant who was a parson, and desired him (having mony in London) to draw a bill to J.S. in whose hands it was, to pay the plaintiff, and that he would repay the parson in the country, which was done by the parson, with private advise to J.S. not to pay the plaintiff till he had received the mony of the butcher, who broke and became insolvent, and so on default of payment by J.S. the plaintiff brings an action upon the case against the parson, suggesting the custom of merchants to be, that if any merchant or trader, or other negotiating for him, procure or do draw any bill unto any other merchant, or other negotiating for him in England, that then, if he to whom such bill is directed, do refuse to pay, he that drew the bill shall be chargeable;

In that case, the bill of exchange was used to remit funds from 'the country' to London, in payment from butcher-buyer to plaintiff-seller, with the parson acting as a paymaster, using JS, who held funds for him, as his correspondent in

*Assumpsit* in *Slade's Case* (1602) 4 Coke Rep. 91a, 92b, 76 E.R. 1072, 1074, reproduced in part in Fifoot, *ibid* at 371. According to Baker, *ibid* at 393, '*Slade's Case* . . . practically put an end to wager of law.' For wager of law, see n 32 above.

<sup>226</sup> See above, text at and cites in n 217.

<sup>227</sup> Examples are *Martin v Boure* (1602) Cro. Jac. 6, 79 E.R. 6, being 'an *assumpsit* on an undertaking to pay the value of so much English, in Spanish money', and *Oaste v Taylor* (1612) Cro. Jac. 306, 79 E.R. 262, being an '*assumpsit*', albeit on an 'acceptance of a bill of exchange' which 'amounts, by the law merchant, to a promise to pay it.'

<sup>228</sup> Two other major innovations are associated with the case. First, to be held liable on a bill, a party need not strictly speaking be a 'merchant'. See an earlier proceeding in the same case, *sub nom Edgar v Chut* (1663) 1 Keble 592, 83 E.R. 1130 where it was successfully argued that 'merchant is to be referred only to him to whom the bill is directed, and to the procurers of such bill'. See Rogers, above n 4 at 140, 182. Second, this was an inland (rather than foreign) bill. See Holden, above n 200 at 54, according to whom this 'appears to be the earliest reported case, in the Common Law Courts, of an action on an inland bill.'

<sup>229</sup> 1 Keble 636, 83 E.R. 1156.



London. Judgment was given against the parson, the drawer of the bill, notwithstanding the failure of consideration between the remitter (the butcher-buyer) and the drawer (the parson), caused by the remitter's insolvency. In holding for payee/plaintiff-seller, the court effectively accepted his argument and thus theorized drawer's liability to the payee in 'an action upon the case' on the basis of 'the custom of merchants.' In effect, the parson, having lent to the butcher and expecting to be repaid by him ('in the country'), undertook to pay plaintiff-seller (in London). However, unlike under an exchange transaction, in suing the drawer-parson, payee/plaintiff-seller was not exercising a remitter's right against the drawer, but rather, his (plaintiff-seller)'s own right. Nor was drawer-parson a 'taker' of money, that is, borrower, from the remitter, but rather his lender.<sup>230</sup> Hence, legal doctrine that developed to accommodate the exchange transaction was ill-fit to cover the newly emerging remittance facility; this forced new thinking on the matter of the drawer's liability to the payee,<sup>231</sup> an aspect that, as discussed in the previous chapter,<sup>232</sup> was overlooked as late as in the second half of the seventeenth century in Marius' work on bills of exchange.<sup>233</sup>

Indeed, already as a matter of contemporary common law doctrine, in a transaction in which the drawer dealt directly with the payee, 'an implicit but real undertaking' made by the drawer to the payee 'could reasonably be said' to exist, so as to be actionable in *Assumpsit*.<sup>234</sup> However, in the facts of *Chat and Edgar Case*, drawer-parson's bill of exchange reflected his promise given to the butcher; in that sense there was no privity between drawer-parson and payee-seller, and it could probably not even be shown that the butcher was the intended beneficiary of drawer-parson's promise to pay.<sup>235</sup> Nonetheless, bypassing the issue altogether, the Court found drawer-parson liable. Interestingly, not having signed the bill, that is, having not become an acceptor, JS was not even sued, though unlike the parson he was in London and possibly owed money to the parson (that is, held funds for him).

Of particular interest is the theory of liability fastened on drawer-parson. Against the absence of privity between the drawer and the payee or even an intention by the drawer to benefit the payee, the court bypassed the tormented route of adaptation of Roman law principles, as carried out by Continental scholars;<sup>236</sup> rather, in reaching its decision, the court purported to rely on 'the

<sup>230</sup> In fact, to be precise, in the context of the facts of the case, butcher-buyer remitted borrowed funds that he had not received in specie from the lender, the drawer of the bill.

<sup>231</sup> To that effect, see also Rogers, above n 4 at 125–26.

<sup>232</sup> See ch 8, section 4, text at n 242 above.

<sup>233</sup> J Marius, *Advice Concerning Bills of Exchange* (London: printed for Robert Horne, 1684). Marius first published his book under the same title in 1651, albeit in a shorter version.

<sup>234</sup> JH Baker, 'The Law Merchant and the Common Law Before 1700' (1979), 38 *Cambridge Law Journal* 295 at 311 (hereafter: Baker, 'Law Merchant').

<sup>235</sup> I am cognizant of the fact that in the course of the seventeenth-century privity requirements were not rigid, and yet, a party not in privity, namely, a party other than the promisee, could not sue on a promise, unless he was intended by the promissor to benefit from it. See Simpson, above n 2 at 475–85.

<sup>236</sup> Fully discussed in ch 8, section 4 above.

custom of merchants.' In thus echoing the basis for the successful action in *Burton v Davy* (1437),<sup>237</sup> viz, 'the law merchant and custom of the city of London . . . from a time of which no memory survives,'<sup>238</sup> the court struck two birds with one stone. First, it avoided the need for a painful doctrinal soul-searching exercise. Second, it linked the decision to an old rationale already used to fasten liability on a bill of exchange, albeit on the drawee and not the drawer, and as argued, for the purpose of either jurisdiction and/or the meaning of a bearer clause in a bill.<sup>239</sup> At the same time, almost in passing, a major innovation came about: a drawer was held liable to a payee even in the absence of privity and actual intention to benefit him, and notwithstanding the failure of consideration between the drawer and the remitter. And in reconfirming the basis of liability in Case, the parent of *Assumpsit*, the court kept the adherence to the general theory of liability for damages for the breach of contract.<sup>240</sup>

*Burton v Davy* (1437)<sup>241</sup> may further be responsible for an emerging interchangeability between 'law merchant' and 'custom'.<sup>242</sup> The conventional wisdom is that in recognizing bills of exchange, common law 'received' along with them 'the law which had grown up around them on the Continent.' This occurred in a process of 'reception [that] took place under cover of the recognition of mercantile custom.' Ultimately, this body of imported 'mercantile custom' was adapted to be accommodated in the framework of common law vocabulary and legal doctrine.<sup>243</sup> Indeed, reliance on the custom of merchants in pleadings for actions on bills of exchange in common law courts is traced by Rogers to the early part of the seventeenth century. Towards the middle of that century, reference to the delivery of money in exchange transactions is omitted and adaptation is made to the transformation of the use of the bill of exchange. In the late seventeenth century a detailed recital of mercantile custom disappears. Along the way, any reference to a particular local usage which requires proof is superseded by general custom of the realm that is alleged to exist from time immemorial so as to become part of the common law of England.<sup>244</sup> However, the core of the form of action remained fairly static; thus, for example, *Barnaby v Rigalt* (1635)<sup>245</sup> dealt with an 'action of the case upon an *assumpsit*' in which the plaintiff 'declares upon the custom of merchants,' while *Brown v London* (1670)<sup>246</sup> was concerned with an 'action upon the case' in which the 'plaintiff declared upon the custom of merchants.' Holden speaks in general of an 'action on the case upon the custom of merchants'.<sup>247</sup>

<sup>237</sup> Above n 190.

<sup>238</sup> Text at n 197 above.

<sup>239</sup> See text and nn 206–12 above.

<sup>240</sup> See paragraph containing nn 218–22 above.

<sup>241</sup> Above n 190.

<sup>242</sup> See quoted language in text at n 238 above.

<sup>243</sup> Holdsworth, vol VIII, above n 3 at 151.

<sup>244</sup> See detailed analysis by Rogers, above n 4 at 137–50.

<sup>245</sup> Cro. Car. 301, 79 E.R. 864.

<sup>246</sup> 1 Vent. 152, 86 E.R. 104.

<sup>247</sup> Holden, above n 200 at 33.

Reliance on custom as a source of innovation in the common law, expanding the frontiers of liability is nonetheless not unique to bills of exchange; rather, it goes back to the early development of Case, as the instrument for expanding civil liability in general. Thus, in *The Innkeeper's Case* (1369),<sup>248</sup> liability was fastened on the innkeeper of 'a common inn' who, together with his servants, broke a duty to 'keep (*garde*) the goods and chattels which their guests had in their rooms within the inn while they were lodged there'. The source of that duty was identified as 'the custom and use' prevalent 'throughout the whole kingdom of England.'<sup>249</sup> Less than half a century later, in *Beaulieu v Finglam* (1401),<sup>250</sup> the plaintiff successfully counted 'upon a common custom of the realm' that 'a man shall answer for his fire, which by misfortune burns another's goods.' The defendant's plea that the plaintiff had not pleaded that the custom went back to time immemorial was summarily dismissed by the entire court, saying that 'the common custom of the realm is the common law of the realm.'<sup>251</sup> The existence of a duty fastened on 'every man of the . . . realm . . . to keep his fire safely' was subsequently argued on the basis of 'the law and custom of this realm of England' in *Turberville v Stamp* (1697);<sup>252</sup> while this was an '[a]ction upon the case on the custom of the realm', in holding for the plaintiff, the majority recognized the duty of every man to 'use his own as not to injure another' as a matter of '[t]he law [in] general.'<sup>253</sup> As well, just a bit more than a quarter of a century earlier, in *Morse v Slue* (1671),<sup>254</sup> in an action upon the Case against a master of a ship, the plaintiff declared that 'according to the law and custom of England, masters and governors of ships which go from London beyond sea . . . are bound to keep safely day and night' goods which they carry 'without loss or subtraction'.<sup>255</sup> Judgment was given for the plaintiff.<sup>256</sup>

The reports of these cases do not contain any record of evidence put forward as to the existence of the alleged custom. Nor do they contain any hint as to a factual dispute as to its existence. In this light, in saying that 'the common custom of the realm is the common law of the realm',<sup>257</sup> judges took upon themselves the power to expand common law liability as they saw fit by reference to a vague, tenuous, and in fact fictitious source, which they referred to as 'custom of the realm'. How far they felt free to go in this direction, other than in cases where there was some societal notion of a duty and expectation that it would be enforced in common law courts, is not to be determined in the present discussion.<sup>258</sup> Suffice it to say

<sup>248</sup> Y.B. Easter 42 Ed. 3, f.11, pl. 13, as reproduced in Fifoot, above n 15 at 80.

<sup>249</sup> *Ibid.*

<sup>250</sup> Y.B. 2 Hen. 4, f.18, pl. 6, as reproduced in Fifoot, *ibid* at 166.

<sup>251</sup> *Ibid.*

<sup>252</sup> 3 Ld. Raymond, 375, as reproduced in Fifoot, *ibid* at 167.

<sup>253</sup> 12 Mod. 152, 88 E.R. 1228, Fifoot *ibid* at 168.

<sup>254</sup> 1 Ventris, 190, 86 E.R. 129, Fifoot *ibid* at 171.

<sup>255</sup> *Ibid.*

<sup>256</sup> 2 Lev. 69, 83 E.R. 453. See also 1 Ventris 238, 86 E.R. 159, Fifoot *ibid* at 172.

<sup>257</sup> Text at n 251 above.

<sup>258</sup> To a large extent, the issue overlaps with the broader issue as to the source and scope of Case in general, for which see Fifoot, above n 15 at 66–92.

that, as discussed at the beginning of this section, by itself, liability on bills of exchange had already been recognized as a matter of general common law doctrine; what was required was a shift in the legal thinking, to continue to uphold liability even when the use of the bill of exchange changed, so as to render a party liable even when he was not in privity with the plaintiff, and did not actually intend to benefit him.<sup>259</sup>

It is in this setting that 'the common custom of the realm' could be used as a source of a new law, no less than in the case of the duty of an innkeeper, the duty to watch fire, and the duty of a common carrier. In fact, in the absence of earlier precedents albeit in varied circumstances, as in the case of liability on the bill of exchange, all of such cases are even weaker. However, in the final analysis, 'the common law of the realm' is formed by 'the common custom of the realm', only insofar as the latter is perceived and defined by judges, as a pure question of law. As such, 'the law of merchants is the law of the land, and the custome is good enough generally for any man, without naming him merchant.'<sup>260</sup>

Thus, as a manifestation of 'the common custom of the realm', 'law merchant' was not a body of well-defined substantive law, governing rights and liabilities of parties to a transaction or instrument, imported from elsewhere; in fact, as demonstrated in chapter eight above, there was no external law to be imported from elsewhere. Nor was it a self-contained autonomous set of mercantile usages.<sup>261</sup> Rather, as observed by Rogers,<sup>262</sup> the reference to mercantile practice or usage, as local or otherwise limited and not general custom, allowed judges to admit evidence on mercantile matters as they deemed helpful and fit, with the view of ensuring the accommodation of the needs of the mercantile community.<sup>263</sup> Nonetheless, the final word was that of the law. To that end, 'the custom of the realm', deemed to be universal, general, and ancient, was just another avenue for Case to take over and expand liability in the common law.

<sup>259</sup> Certainly, if a drawer's liability could be upheld against a plaintiff-payee without privity or intention to benefit, as in *Chat and Edgar Case* (1663), above n 229, it is only logical that a drawer, as well as an endorser, could be held liable to plaintiff-remote endorsee without privity or intention to benefit (as seems to be observed by Baker, *Law Merchant*, above n 234 at 311). A drawer's liability to the last endorsee was assumed to exist in *Claxton v Swift* (1685) 3 Mod. 86, 87 E.R. 55. For a remote endorser's liability to the last endorsee see *Anon* (1694) Holt, K.B. 115, 90 E.R. 962 ('an action . . . by the last indorsee against the first indorser'), and *Williams v Field* (1694) 3 Salk. 68, 91 E.R. 696 ('the last indorsee may bring an action against any of the indorsers').

<sup>260</sup> *Woodward v Rowe* (1666) 2 Keb. 105 and 132 (at 32–33); 84 E.R. 67 and 84 (at 84), and see Holden, above n 200 at 31–36.

<sup>261</sup> Having enumerated at the beginning of his article (at 295–96) various orthodox views as to the derivation of 'law merchant' such as from Roman law, natural law, or mercantile custom, Baker was prepared (in line with the situation in the Continent as stated at the end of ch 8 above) to 'settle' on its existence as 'an expeditious procedure especially adapted for the needs of men who could not tarry for the common law.' Baker, 'Law Merchant', above n 234 at 301. But cf for his ultimate conclusion, text at n 278 below.

<sup>262</sup> Rogers, above n 4 at 143, 150.

<sup>263</sup> See eg *Tassell and Lee v Lewis* (1701) 1 Ld. Raym. 743, 91 E.R. 1397, where the Lord Holt ruled on the basis of evidence put forward by merchants as to a custom for three days of grace for payment on a foreign bill of exchange.

By the end of the seventeenth century, the exploration of this quasi-mystical 'law merchant' as part of the 'custom of the realm' appears to play only a secondary role in the establishment of law governing the liability of parties to bills of exchange. Three judgments involving Lord Holt are of particular interest. First, *Anon* (1694)<sup>264</sup> was 'an action upon the case' on a bill of exchange 'brought by the last indorsee against the first indorsee.' In the view of Lord Holt, '[t]he action well lies; for the indorsement is quasi a new bill, and a warranty by the indorser, that the bill shall be paid.'<sup>265</sup> Neither custom nor law merchant was mentioned.

Second, *Anon* (1696)<sup>266</sup> was an action in *Indebitatus Assumpsit*<sup>267</sup> 'upon a bill of exchange'. Since 'the action was brought by the first indorser, who struck off the several [subsequent] indorsements' rather than receiving the bill from the last endorsee by endorsement, this indeed was an action on the underlying debt so as to enable Lord Holt to contrast it with an action 'upon the custom'. However, he went on to say that 'a bill of exchange might be accepted by parol, tho' the usual way be to do it by writing.'<sup>268</sup> Not overruling Marius altogether as to the sufficiency of an oral acceptance,<sup>269</sup> Lord Holt nevertheless thereby lay down the present day writing and signature requirements for the acceptance of a bill of exchange.<sup>270</sup> While entitlement to sue was given to the owner in possession under general law, a defendant's liability was established under the law of bill of exchange, in the context of *Indebitatus Assumpsit*.

Third,<sup>271</sup> *Starke v Cheeseman* (1700)<sup>272</sup> was 'an action upon the case upon a bill of exchange' in which the drawer was held liable in *Assumpsit* on a promise implied in the drawing of the bill.<sup>273</sup> Interestingly, 'at the beginning', Lord Holt was inclined to side with the defendant, who argued that the drawer was liable not in *Assumpsit*, but rather, if at all, in Deceit, for the breach of warranty of payment

<sup>264</sup> Above n 259.

<sup>265</sup> *Ibid.* At present, an endorser's liability to the holder upon the dishonour of the bill is set out in s 55(2)(a) of the *Bills of Exchange Act*, 1882 (UK), 45 & 46 Vict., c. 61, as amended, (BEA) (which nonetheless departs from the case in not making the endorser liable only 'upon the drawer's default of payment' as required by the case: above n 259).

<sup>266</sup> Holt, K.B. 296, 90 E.R. 1063.

<sup>267</sup> For more on this count as a variant of *Assumpsit*, see text and n 286 below.

<sup>268</sup> Above n 266 at 297 (Holt, K.B.), 1063 (E.R.).

<sup>269</sup> Marius (1684), above n 233 at 16 (10 in the 1651 original edition, *ibid.*). See ch 8, text at n 236 above.

<sup>270</sup> The statutory requirement for writing goes back to the *Promissory Notes Act*, 1704 (UK), 3 & 4 Ann., c. 8 (Chapter IX in the Common printed Editions) Sections VI and VII. Persistent judicial doubts resulted in two subsequent statutory pronouncements clarifying the point. See Holden, above n 200 at 103–05, 149–53. At present, the writing and signatures requirements for 'acceptance' are set out in BEA s 17(2)(a), above n 265. For the signature requirement see also BEA s 23.

<sup>271</sup> Logically, a drawer's liability is to be discussed ahead of an endorser's liability, as the latter is equated with the former. The sequence in the present discussion follows the chronological sequence of cases.

<sup>272</sup> 1 Ld. Raym. 538, 91 E.R. 1259.

<sup>273</sup> At present, a drawer's liability to the holder upon the dishonour of the bill is set out in BEA s 55(1)(a), above n 265.

given by the act of drawing.<sup>274</sup> Ultimately, however, judgment was given for the plaintiff, 'because the drawing of the bill was an actual promise.'<sup>275</sup> 'Custom' as a basis for the action was only mentioned by the plaintiff in argument.<sup>276</sup>

In sum, 'law merchant' and 'custom' were effective tools in the development of the common law as it had been positioned to cover the bill of exchange at the time its use had been transforming. With the ever-growing expansion of commerce, more than true sources for normative rules, 'law merchant' and 'custom' were vocabulary, codes for a set of terms, or a frame of reference, which allowed common law courts to expand the frontiers of liability with the view of satisfying the requirements and expectation of the mercantile community. The alleged 'reception'<sup>277</sup> 'was in reality nothing other than a refinement of the common law which had always governed mercantile affairs.'<sup>278</sup> By the end of the seventeenth century, the utility of 'law merchant' and 'custom' as facades to the actual development of common law principles of liability faded;<sup>279</sup> the legal jargon had adapted itself to the reality of judge-made law. It is in this process of legal evolution and adaptation of terminology that rules governing the holder's right, at least as a payee or endorsee, of a bill of exchange payable to order,<sup>280</sup> had been firmly settled in England. In the final analysis, in England, the law of bills of exchange, as part of the common law as codified, is unique not because of its origin, but rather only because it covers a unique, specialized, and complex instrument.

## 5. THE BAILMENT OF MONEY AND THE BILL OF EXCHANGE AS PAYMENT MECHANISMS: A COMPARISON

In retrospect, Medieval legal doctrine, which had developed to accommodate the bailment of money, provided for the basic elements of funds transfer law. To begin with, as already discussed in section 2,<sup>281</sup> with the link provided by *Bretton v Barnet* (1599),<sup>282</sup> the bailee-bailor debt relation, pronounced in the 1368

<sup>274</sup> Certainly, on the defendant's part, this is not to be taken as an admission of liability; rather this must have been a strategy designed to lead to the dismissal of the plaintiff's *Assumpsit* claim that, under procedures then in force, would have forced the plaintiff to start all over again and bring a new action in Deceit (where he would expect the defendant to deny liability in Deceit).

<sup>275</sup> Above n 272 at 539 (Ld. Raym.), 1260 (E.R.).

<sup>276</sup> *Ibid* at 538 (Ld. Raym.), 1260 (E.R.).

<sup>277</sup> For this alleged reception as the orthodox position, see n 3 above and text around it.

<sup>278</sup> Baker, 'Law Merchant', above n 234 at 322.

<sup>279</sup> But *cf* the mercantile jury system subsequently established by Lord Mansfield (in the second half of the eighteenth century) that facilitated the integration of commercial usage into various common law rules. See Holden, above n 200 at 114.

<sup>280</sup> In contrast, the bearer's standing to bring an action on a bill stated payable to a named payee or bearer had not been settled yet, albeit it was recognized that a drawee who paid the bearer in good faith is discharged. See eg *Hinton's Case* (1682) 2 Show. K.B. 235, 89 E.R. 911; and *Hodges v Stevard* (1692) 1 Salk. 125, 91 E.R. 117, both discussed by Holden, above n 200 at 59–61.

<sup>281</sup> See text around n 76 to the end of section 2 above.

<sup>282</sup> Above n 46.

*Anonymous* case<sup>283</sup> and established in *Core's Case* (1537),<sup>284</sup> is the ancestor of the rule that the relationship between a banker and customer as to deposited money is that of debtor and creditor.<sup>285</sup>

A complementary aspect of funds transfer law covered by Medieval doctrine governing the bailment of money (already discussed in section 3), is the beneficiary's right to recover the bailed money directly from the bailee, with whom he had not been in privity. He could first bring Account against the bailee, and subsequently, also Debt. During the seventeenth century, *Indebitatus Assumpsit* took over Debt and substantial parts of Account.<sup>286</sup> In *Indebitatus Assumpsit*, the beneficiary's action against the bailee fell under the count of money had and received.<sup>287</sup> Nevertheless, until the late eighteenth or early nineteenth century, the substantive law governing the beneficiary's remedy against the bailee remained unaltered.<sup>288</sup> The beneficiary could sue the bailee in money had and received irrespective of the absence of any consideration or privity between them.<sup>289</sup> As further indicated, on the basis of *Israel v Douglas* (1789),<sup>290</sup> the beneficiary could maintain his action against the bailee not only with respect to money specifically delivered by the bailor to the bailee for the purpose of paying it to the beneficiary, but also with respect to money already held by the bailee, which the bailor instructed the bailee to pay to the beneficiary.<sup>291</sup> In fact, it is in this application that the bailment of money 'perfected' itself to become a payment mechanism for the transfer of funds out of a bank deposit.<sup>292</sup>

Another aspect of funds transfer law that developed under Medieval legal doctrine is the emergence of a framework dealing with the discharge of the bailor's debt to the beneficiary. According to *Harris v De Bervoir* (1624),<sup>293</sup> bailment of money to be delivered to the beneficiary in payment of a debt owed to him by the bailor is not countermandable.<sup>294</sup> This suggests that control of the funds

<sup>283</sup> Above n 22. See text and nn 22–26 above.

<sup>284</sup> Above n 41. See text and nn 41–42 above.

<sup>285</sup> The landmark case is *Foley v Hill* (1848) 2 H.L.C. 28, 9 E.R. 1002. The modern authority is *Joachimson v Swiss Bank Corp* [1921] 3 K.B. 110. See also *Pott v Clegg* (1847) 16 M. & W. 321, 153 E.R. 1212.

<sup>286</sup> The turning point is *Slade's Case*, above n 225, Fifoot, above n 15 at 371. For an extensive discussion, see D Ibbetson, 'Assumpsit and Debt in the Early Sixteenth Century: The Origins of the Indebitatus Count' (1982), 41 *Cambridge Law Journal* 142, and D Ibbetson, 'Sixteenth Century Contract Law: *Slade's Case* in Context' (1984), 4 *OJLS* 295.

<sup>287</sup> The transition is discussed by Jackson, above n 2 at 93–95.

<sup>288</sup> For the nineteenth-century 'transformation' (or in fact demise), see the concluding paragraphs of this section below.

<sup>289</sup> According to Jackson, above n 2 at 94, 'the first clear case of indebitatus assumpsit' by the beneficiary against the bailee is *Beckingham and Lambert v Vaughan* (1616) 1 Rolle Rep. 391, 81 E.R. 557, where '[n]othing was said about consideration or privity.' See also *Brown v London* (1670) 1 Vent. 152, 86 E.R. 104; 1 Mod. 285, 86 E.R. 889.

<sup>290</sup> Above n 142.

<sup>291</sup> See text that follows n 142 above.

<sup>292</sup> As in fact suggested by SJ Stoljar, *A History of Contract at Common Law* (Canberra: Australian National University Press, 1975) at 140 (hereafter: Stoljar: *History*).

<sup>293</sup> Above n 136.

<sup>294</sup> See text between nn 136 and 137 above.



passes to the beneficiary upon the delivery of the money to the bailee. Upon delivery to the bailee, the bailor may not countermand payment to the beneficiary. It follows, then, that delivery of money to the bailee discharges the bailor, and the beneficiary must look for payment, as of that time, to the bailee. Yet the bailee's refusal to pay the beneficiary entitles the bailor to bring Debt against the bailee.<sup>295</sup> This suggests that the bailment of money operates as conditional, rather than absolute payment;<sup>296</sup> after all, it would not have made sense to allow the return of the money to the bailor unless he remains liable to the bailee.<sup>296.1</sup> Presumably, a bailee who returns the money to the bailor is excused as against the beneficiary.<sup>297</sup>

The conclusion as to the conditional discharge effected by the bailment of money is foreshadowed by the reasoning of case law rejecting the application of *Indebitatus Assumpsit* to the payee's action against the acceptor of a bill of exchange. Thus, it was held in *Anon* (1668)<sup>298</sup> that:

an action of debt would not lie upon a bill of exchange accepted, against the acceptor: but that a special action upon the case must be brought against him. For that the acceptance does not create a duty, no more than a promise made by a stranger, to pay . . . if the creditor will forbear his debt. And he that drew the bill continues debtor, notwithstanding the acceptance; which makes the acceptor liable to pay it.

Similarly, shortly thereafter, *Browne v London* (1670)<sup>299</sup> dismissed the endorsee's claim in *Indebitatus Assumpsit* against the acceptor of the bill of exchange. In reaching the decision, the court acknowledged similarity with the earlier case,<sup>300</sup> and went on to reason that 'acceptance is but conditional' or 'collateral' so that upon the acceptor's default 'the drawer of the bill . . . remains liable.'<sup>301</sup>

Stated otherwise, the conditional discharge of the drawer/debtor effected by the acceptor/'stranger' is said to preclude liability in debt or *Indebitatus Assumpsit*.<sup>302</sup> It seems then to follow that inasmuch as the latter became the action of the beneficiary against the bailee, the bailment of money is incapable of effecting the conditional discharge of the bailor/debtor to the bailee/beneficiary.

Certainly, this analysis flies in the face of the reasoning that led to the conclusion as to the conditional payment effected by the bailment of money on the

<sup>295</sup> See section 2 of this chapter above.

<sup>296</sup> As to the nature of this conditional payment, see paragraph containing nn 309–11 below, and compare with paragraph containing nn 320–21 below.

<sup>296.1</sup> Certainly, a bailor excused from making payment to the beneficiary may keep the money returned by the bailee. I am dealing with the case in which the bailee's refusal is not on the basis of the beneficiary's lack of entitlement from the bailor.

<sup>297</sup> For the anomaly created thereby, see paragraph containing nn 314–16 below.

<sup>298</sup> Hardres 485 at 487, 145 E.R. 560 at 561.

<sup>299</sup> 1 Mod. 285, 86 E.R. 889.

<sup>300</sup> Referring to it as '*Milton's case*', *ibid* at 286 (Mod.), 889 (E.R.).

<sup>301</sup> *Ibid*.

<sup>302</sup> The latter was an action in *Indebitatus Assumpsit* and, in the former, interchangeability between Debt and *Indebitatus Assumpsit*, set out above in the second paragraph of this section, is repeatedly mentioned throughout the report.

basis of the survival of the bailor's claim against the bailee.<sup>303</sup> This suggests that the reasoning in both cases is flawed; as a matter of fact, rather than precluding an *Indebitatus Assumpsit* on a bill of exchange, the cases are to be understood as questioning the standing of a third party, a 'stranger' to a promise,<sup>304</sup> whether a payee of a bill of exchange or a beneficiary under the bailment of money, to bring an *Indebitatus Assumpsit*. Indeed, in *Anon* (1668), 'privity' played a role in argument;<sup>305</sup> under *Browne v London* (1670), the reporter explains, *Indebitatus Assumpsit* is allowed between parties in privity, such as the payee and the drawer, the drawer and the acceptor, or an endorsee and his immediate endorser, but not between parties not in privity, such as the endorsee and the acceptor.<sup>306</sup> As will be seen below, it is 'privity' that ultimately led to significantly restricting the beneficiary's right against the payee.<sup>307</sup> It would have been enough for the court to say that in contrast to a bailee of money, a drawee/acceptor does not necessarily hold funds for the drawer, and hence, as a general rule, Debt or *Indebitatus Assumpsit* is too narrow and hence is inappropriate for a payee's action against the acceptor.<sup>308</sup>

It may thus be concluded that the bailment of money gave rise to a debt owed by the bailee to the bailor, to a debt owed by the bailee to the beneficiary, and to the conditional discharge of the debt owed by the bailor to the beneficiary. Payment by the bailee to the beneficiary discharged both his debts, to the bailor as well as to the beneficiary. It also gave absolute discharge to the bailor's debt to the beneficiary. Payment by the bailee to the bailor discharged the bailee's debt to the bailor, and presumably also to the beneficiary. Upon such payment, the bailor's debt to the beneficiary must have been revived.

The operation of the bailment of money as a payment mechanism left open four major questions. The first question was concerned with the bailee's failure to pay both the bailor and the beneficiary, and its effect on the discharge of the bailor's debt to the beneficiary. Did the bailor's debt to the beneficiary revive upon the bailee's failure to pay the beneficiary<sup>309</sup> or, rather, was it revived only upon the bailee's payment to the bailor, following the bailee's failure to pay the beneficiary? As a matter of policy, the bailor to whom the bailee did not return the money, should have been excused, if at all, only where the defaulting bailee was initially nominated or at least approved by the beneficiary. It could have been argued that in such a case the beneficiary had assumed the risk of the bailee's default.<sup>310</sup> This question relates to the nature of the conditional dis-

<sup>303</sup> See text and nn 293–97 above.

<sup>304</sup> Indeed, inasmuch as the acceptor is a 'stranger' vis-a-vis the payee (above, text that follows n 298), so is the payee vis-a-vis the acceptor.

<sup>305</sup> See eg second argument, above n 298 at 485 (Hardres), 560 (E.R.).

<sup>306</sup> Above n 299 at 286 (Mod.), 889 (E.R.).

<sup>307</sup> See below, text that follows n 349, until after n 365.

<sup>308</sup> This reasoning would have been consistent with the judgment of Lord Holt in *Anon* (1696), above n 266, where he allowed *Indebitatus Assumpsit* brought by an endorsee against an acceptor where a debt actually existed. See text around n 267 above.

<sup>309</sup> As it is in connection with bills of exchange. See text around n 320 below.

<sup>310</sup> Cf text around n 91 above.

charge effected by the bailment of money.<sup>311</sup> It is reminiscent of the Talmudic discussion on payment by a debtor to an emissary nominated by the creditor, which was discussed at length in chapter seven, section 2.4 in connection with the *dyokani*; unfortunately, it was overlooked in the common law discussion on the bailment of money.

The second question related to the scope of the rule providing that the bailment of money was not countermandable.<sup>312</sup> Did this rule apply also to situations where the bailor had defences against the beneficiary? Did the rule mean that the bailment could not be rescinded by the bailor on the basis of his defences against the beneficiary, so that under no circumstances could money be recalled by the bailor from the bailee who had not paid yet to the beneficiary? Medieval common law provided for limited rescission rights of defrauded parties.<sup>313</sup> Whether a defrauded bailor had such rights had not been determined, or even discussed.

The third question related to the position of a bailee who complied with the bailor's ineffective countermand and returned the money to the bailor. Was the bailee liable to the beneficiary under these circumstances? No discussion is available. Nevertheless, prior to the introduction of Case, such liability seemed quite tenuous.<sup>314</sup> Inasmuch as repayment by the bailee to the bailor discharged both Debts owed by the bailee, the one to the bailor and the other to the beneficiary,<sup>315</sup> no liability on the bailee's part seemed conceivable. This would, however, lead to the incongruous result where the bailee, while not being obligated to abide by the bailor's countermand, was completely free to comply with it, as long as he had returned the money to the bailor.<sup>316</sup>

Finally, the fourth question was concerned with the beneficiary's position towards the state of account between the bailor and the bailee. At stake was the bailee's possible right to act in defiance of the bailor's instructions as well as the beneficiary's demand, and apply the money bailed to him to the satisfaction of a pre-existing liability or indebtedness of the bailor to the bailee. Did the bailee have such a right? Did his state of account with the bailor supersede the Debts created by the bailment of money? Stated otherwise, the question was whether the beneficiary's right against the bailee was free from claims and defences the bailee might have had against the bailor.<sup>317</sup> Medieval common law did not consider this question.

Compared to the bailment of money, the bill of exchange reflects a more sophisticated application of legal doctrine to the transfer of funds. Indeed, as

<sup>311</sup> Cf text around n 296 above.

<sup>312</sup> For this rule, see text and nn 136–39 above.

<sup>313</sup> See eg Milsom, above n 15 at 320. The question remained unanswered also under the law of bills of exchange. See paragraph containing nn 331–32 below.

<sup>314</sup> Cf n 71 above.

<sup>315</sup> Cf paragraph containing nn 180–82 above.

<sup>316</sup> For the treatment of the corresponding question under the law of bills of exchange, see paragraph containing nn 322–24 below.

<sup>317</sup> For the treatment of the corresponding question under the law of bills of exchange, see text at nn 325–39 below.

outlined above in section 4, the bill of exchange became a machinery under which a drawer transmits funds to a payee via a third-party drawee.<sup>318</sup> In general, the drawer of a bill of exchange corresponds to the bailor of money. The acceptor, namely the drawee of a bill of exchange who undertook to pay it, corresponds to the bailee. Finally, the payee of a bill of exchange corresponds to the beneficiary. It was accordingly stated that 'if A. delivers money to B. to pay C. and gives C. a bill of exchange drawn upon B. and B. accepts the bill, and doth not pay it, C. may bring an indebitatus assumpsit against B. as having received money to his use: but then he must not declare only upon a bill of exchange accepted'. Stated otherwise, C could sue B either as the bailee of the money or as the acceptor of the bill.<sup>319</sup> The law relating to the latter action will now be compared with that relating to the former. In turn, this discussion will shed light on the contemporary relevance of the medieval concepts developed to accommodate the bailment of money as a payment mechanism.

Three doctrines developed by the law of bills of exchange were central to the superior nature of the bill of exchange as a payment mechanism. The first is the doctrine of conditional payment. The second is the doctrine relating to the acceptor's liability. The third is the doctrine of the holder in due course as may be understood in its original form.

Under the doctrine of conditional payment, when a bill of exchange is taken by a creditor in payment of a debt, unless otherwise agreed, the debt is suspended. If the bill is paid, the debt is absolutely discharged. If the bill is dishonoured, the original indebtedness is revived.<sup>320</sup> This doctrine provides for an answer to the first question left open in connection with the operation of the bailment of money as a payment mechanism.<sup>321</sup> Thus, unless otherwise agreed, the drawer/bailor's liability to the payee/beneficiary revives upon non-payment, irrespective of whether the drawee/bailee returned the money to the drawer/bailor.

The second doctrine related to the acceptor's liability. During the seventeenth century, the courts adopted the principle that an acceptance by the drawee was equivalent to a promise to pay enforceable by the payee in 'an action on the case upon the custom of merchants',<sup>322</sup> irrespective of lack of consideration or privity between them.<sup>323</sup> This provides an answer to the third question left open in

<sup>318</sup> See text that follows n 227 above.

<sup>319</sup> *Brown v London* (1670) 1 Vent. 152 at 153, 86 E.R. 104.

<sup>320</sup> For historical origins, see Holden, above n 200 at 85–86 and 109–11, and Holdsworth, vol VIII, above n 3 at 169–70. Early leading authorities are *Ward v Evans* (1702) 2 Ld. Raym. 928, 92 E.R. 120 and *Hill v Lewis* 91 E.R. 124 (1709) 1 Salk. 132, 91 E.R. 124. Both cases, decided by Lord Holt, were concerned with notes but the latter referred to bills as well. Cases providing for recourse against the drawer upon the acceptor's default, such as *Brown v London*, *ibid*, are to the same effect.

<sup>321</sup> See paragraph containing nn 309–11 above.

<sup>322</sup> See in general, Holden, above n 200 at 32–33; and Holdsworth, vol VIII, above n 3 at 162. Leading cases are *Oaste v Taylor*, above n 227; *Barnaby v Rigalt* (1635) Cro. Car. 301, 79 E.R. 864; and *Brown v London*, above n 319.

<sup>323</sup> But *cf* Holden, *ibid* at 28–29. Earlier, during the sixteenth century, the payee's action against the acceptor could be facilitated only with the aid of fictitious agency allegations.

connection with the operation of the bailment of money as a payment mechanism.<sup>324</sup> Thus, the drawee/bailee's liability to the payee/beneficiary is on the basis of the former's engagement as an acceptor of the bill, and irrespective of whether he holds funds. Having complied with the drawer/bailor's ineffective countermand and returned the money to him, the acceptor/bailee is nevertheless not discharged towards the payee/beneficiary.

Finally, the third doctrine of bills of exchange law will be considered. In its original form, what is now broadly described as the holder in due course doctrine could be seen as related to the freedom of the payee's right against the drawee from the drawee's defences against the drawer. The defence-free position of the payee appears to be traced to *Baker v Lambert* and *Grelle v Lambert* (1510–13)<sup>325</sup> where, according to Beutel, 'a drawee [who was sued] . . . by a payee . . . [did] not offer as a defense that the drawer . . . [had been] indebted to him'.<sup>326</sup> However, this was an exchange transaction, so that the drawee was in fact an agent of the drawer and the payee was an agent of the remitter; the payee's action must have been that of the remitter-lender against the drawer-borrower.<sup>327</sup> In such an action, the drawee's defences against his principal, the drawer, are certainly irrelevant. Hence, the case cannot be cited for the broader proposition as to the independent right of the payee against the drawee free of the latter's defences against the drawer.

In any event, in *Baker v Lambert* and *Grelle v Lambert* (1510–13), the drawee did not even accept the bill. At the same time, later, towards the end of the first quarter of the seventeenth century, Malynes confirmed the view that a drawee who accepted a bill could not raise against the payee defences available to him, the drawee, against the drawer.<sup>328</sup> A similar view was expressed by Marius in the middle of the seventeenth century.<sup>329</sup> Both, however, addressed their remarks only to the acceptor's defence based on the insolvency of the drawer. To the extent that they can be taken to have in mind a whole spectrum of defences of the acceptor against the drawer, this provides an adequate answer to the fourth question left open in connection with the operation of the bailment of money as a payment mechanism.<sup>330</sup> The payee/beneficiary's claim against the drawee/bailee is free from the drawee/bailee's defences against the drawer/bailor.

Nevertheless, the operation of the bill of exchange as a payment mechanism became subject to three setbacks. First, the law relating to bills of exchange did

<sup>324</sup> See paragraph containing nn 314–16 above.

<sup>325</sup> Reprinted in (1929) 46 Selden Soc. 2, Select Cases Concerning the Law Merchant 138.

<sup>326</sup> Beutel, above n 199 at 832, fn 94. The facts as to the drawer's indebtedness to the drawee 'appear in the same case.' *Ibid.*

<sup>327</sup> See discussion in text and nn 202–05 (in connection with *Burton v Davy*) and around 217 above.

<sup>328</sup> G Malynes, *Consuetudo, vel Lex Mercatoria* or *The Ancient Law-Merchant* (London: Printed by Adam Islip, 1622) [Electronic Resource] at 401 (1622). See Holden, above n 200 at 41–42. See also Holdsworth, vol VIII, above n 3 at 157.

<sup>329</sup> Marius (1684), above n 233 at 20 (24 in the original 1651 edition, *ibid.*). See Holden, above n 200 at 47.

<sup>330</sup> See paragraph containing n 317 above.

not provide for an answer to the second question left open in connection with the operation of the bailment of money as a payment mechanism.<sup>331</sup> It has not been clear whether the drawer/bailor could effectively prevent the acceptor/bailee from paying the payee/beneficiary on the basis of the drawer/bailor's defences against the payee/beneficiary.<sup>332</sup>

Second, whatever was its original meaning, the holder in due course doctrine has been completely transformed. To accommodate the function of bills and notes as paper currency, the holder in due course doctrine became concerned with the free circulation of the instrument, or with the freedom of its purchaser from adverse claims and prior parties' defences.<sup>333</sup> Indeed, with the recognition in the holder's legal title to a bill of exchange transferred to him by negotiation,<sup>334</sup> it would be quite appropriate nowadays to regard the payee of an accepted bill of exchange as having a derivative title to it, by reference to the debt owed by the drawee to the drawer.<sup>335</sup> From a modern perspective, albeit 'unhistorically',<sup>336</sup> this would have eliminated the need to rely on the 'custom of the realm' as an explanation to the payee's right against the drawer with whom he has not dealt directly,<sup>337</sup> and would have allowed such a payee to be a holder in due course of the instrument, as he is a remote party to the drawer-drawee dealing.<sup>338</sup> However, the prevailing view is that a payee, as an original party to the instrument and not its purchaser, cannot be a holder in due course.<sup>339</sup> In this framework, the freedom of the payee/beneficiary from the drawee/bailee's defences against the drawer/bailor has been cluttered with uncertainties.<sup>340</sup>

Finally, the law of bills of exchange has not adequately considered the effect of the actual bailment of money on the drawee's position. It defined the drawee's liability to the payee in terms of the drawee's formal acceptance of the drawer's payment order.<sup>341</sup> While, by the nineteenth century, the holder of a bill of

<sup>331</sup> See paragraph containing nn 312–13 above.

<sup>332</sup> For a modern discussion see eg B Geva, 'The Autonomy of the Banker's Obligation on Bank Drafts and Certified Cheques' (1994), 73 *Canadian Bar Review* 21, and addendum at 280.

<sup>333</sup> The turning point is *Miller v Race* (1758), 1 Burr. 452, 97 E.R. 398, discussed at length in ch 11, sections 4 and 6.2 below.

<sup>334</sup> Currently, per BEA ss 31 and 38(1), above n 265.

<sup>335</sup> For my take on the subject, albeit in the context of a certified cheque case, see eg B Geva, 'Defences on Cheque Certification: *Esses v. Friedberg*' (2009), 24 *Banking and Finance Law Review* 359.

<sup>336</sup> As, certainly, this option was not available to the seventeenth-century cases dealt with in section 4 above.

<sup>337</sup> See text at nn 236–40 (in connection with *Burton v Davy*) above.

<sup>338</sup> A conclusion effectively reached in *Yan v Post Office Bank Ltd* [1994] 1 N.Z.L.R. 154 (C.A.), in a very indirect way, albeit without acknowledging the holder-in-due course status of the payee. See Addendum, above n 332.

<sup>339</sup> The *locus classicus* for this proposition is *RE Jones Ltd v Waring and Gillow, Ltd* [1926] A.C. 670.

<sup>340</sup> For the view that the payee, though not a holder in due course, may have similar rights against the acceptor, see N Elliott, J Odgers and JM Phillips, *Byles on Bills Of Exchange and Cheques*, 28th edn (London: Sweet & Maxwell, 2007) at 237–38. But see *Ayres v Moore* [1940] 1 K.B. 278 at 288 (C.A.), treating the payee as an immediate (rather than remote) party with the acceptor who, as such, is unable to overcome the acceptor's defence based on a third party's fraud.

<sup>341</sup> See eg BEA ss 23, 53(1), and 17, above n 265.

exchange had been clothed with a legal title so as to be able to sue in his own name,<sup>342</sup> the law of bills of exchange in England firmly rejected the view that the payee could be treated as an assignee of the drawer for the funds entrusted by him to the drawee.<sup>343</sup>

In the process, the law of bills of exchange had overlooked the drawee's possible position as a bailee of money given to him by the drawer for the use of the payee.<sup>344</sup> Indeed, the informal agreement between the drawer and payee could have narrowed the gap between the lack of assignment between the drawer and the payee and the binding effect towards the payee of the drawee's acceptance on the bill of exchange. Thereby it could have also provided for an English common law version of the French doctrine of *la provision*.

Thus, as pointed out in the previous chapter,<sup>345</sup> in the late seventeenth century,<sup>346</sup> under French law of bills of exchange, *la provision* is understood to be constituted by the sum of money held by the drawee for the drawer, or perhaps, more specifically, provided to the drawee by the drawer, with which the drawee is obligated to pay the bill of exchange. In its original meaning under French law, *la provision* gave rise to either a debt or, effectively, a deposit,<sup>347</sup> though the latter term may not have been explicitly mentioned. Thus, upon the delivery of *la provision* by the drawer to the drawee, the drawee's obligation originally inures to the benefit of the drawer; entitlement passes to the payee and each subsequent endorsee with the passage of the instrument to each one as a holder.<sup>348</sup> True, in French law this was possible on the basis of *cessio*,<sup>349</sup> or the

<sup>342</sup> See eg *Liversidge v Broadbent* (1859) 4 H. & N. 603 at 610, 157 E.R. 978 at 980 (per Martin B), and *Crouch v Credit Foncier of England* (1873) L.R. 8 Q.B. 374, at 380–82 (per Blackburn J), presently codified in BEA s 38(1), *ibid*.

<sup>343</sup> Which is the position to this day under BEA s 53, *ibid*. An earlier precedent is *Shand v Du Buisson* (1874) L.R. 18 Eq. 283. For a critique see IFG Baxter, 'The Bill of Exchange as an Assignment of Funds: A Comparative Study' (1953), 31 *Canadian Bar Review* 1131.

<sup>344</sup> At least when this was in fact the case. See text at n 308 above.

<sup>345</sup> See ch 8, section 4, text around n 216 above.

<sup>346</sup> For the statutory reference in 1673, see eg JV Tardon, *La Provision de la Lettre de Change* (droit comparé—loi uniforme) (Paris, Laussane: Pichon, Roth: 1939) at 6.

<sup>347</sup> Cf the distinction in Jewish law between money owed on a loan and on deposit, discussed in ch 7, section 2.1 above. For an earlier meaning, used by Italian and German authors, denoting a commission charged in connection with the issue of a bill of exchange, see eg R Voegelé, *La Provision de la Lettre de Change et son Attribution au Porteur – Étude d'Histoire du Droit et de Droit Comparé (Systèmes Français, Allemand et Suisse)* (Paris: Librairie Générale de Droit et de Jurisprudence, 1947) at 7–12.

<sup>348</sup> For *la provision* in French law, see eg C Gavalda and J Stoufflet, *Instruments de Paiement et de Crédit*, 7th edn edited by J Stoufflet, (Paris: LexisNexis, 2009) at 105–14; and for a summary, P Ellinger, 'Negotiable Instruments' in JS Ziegel (chief ed), *Commercial Transactions and Institutions*, vol IX of U Drobnig and K Zweigert (responsible eds), *International Encyclopedia of Comparative Law* (Tübingen: JCB Mohr, 2000) ch 4 at 110–13. See also G Ripert and R Roblot, *Traité de Droit Commercial*, 13th edn (Paris: Librairie Générale de Droit et de Jurisprudence, 1992) at 181–86. For a more extensive analysis see P Lescot and R Roblot, *Les Effets de Commerce* (Paris: Rousseau, 1953) vol I at 389–465. At present *la provision* is governed in French law by Article L. 511-7 of the Code of Commerce (*Code de Commerce*, Version consolidée au 1 décembre 2009).

<sup>349</sup> For *cessio* under Roman law, see ch 5, section 9 above. For *cessio* in connection with *la provision*, see ch 8, text around nn 220 and 313 above.



assignment of debts (or even a fictive ‘sale of money’); in light of the impossibility for such theories to apply under English law, the bailment of money could have achieved a similar result insofar as it required the consent of the bailee, as expressed between himself and the bailor.

However, not only did the English law of bills of exchange not recognize the transfer to the payee and each successive holder of the drawee’s debt to the drawer, but furthermore, the law of bailment of money regressed on its own. This regression occurred when the common law that governed the bailment of money began requiring not only the bailee’s agreement, but also his agreement with the beneficiary. This undermined altogether the efficacy of the bailment of money as a mechanism for transferring a debt to the payee, and further precluded the convergence with the French doctrine of *la provision* in the law of bills of exchange.

Thus, as of the beginning of the nineteenth century, the potential of the Medieval doctrine relating to the bailment of money to shape funds transfer law and complement the role of the law of bills of exchange in that regard was significantly compromised. This was concurrent with the imposition of restrictions to which the beneficiary became subject in *Indebitatus Assumpsit*. Briefly stated, the classification of *Indebitatus Assumpsit* as a category of *Assumpsit* led to the reconstruction of the walls of privity,<sup>350</sup> which seemed to have earlier crumbled under Debt.<sup>351</sup>

*Williams v Everett* (1811)<sup>352</sup> is widely considered as the turning point.<sup>353</sup> This action in *Indebitatus Assumpsit* concerned the entitlement to proceeds collected by the defendant for a third party who was indebted to the plaintiff and others. The third party (‘bailor’) instructed the defendant (‘bailee’) to pay the plaintiff (‘beneficiary’) and his other creditors. The beneficiary’s action against the bailee failed since defendant-bailee did not appropriate the money for plaintiff-beneficiary. It was correctly pointed out<sup>354</sup> that, as such, the decision was in line with previous case law requiring the bailee’s agreement,<sup>355</sup> and in fact followed *Israel v Douglas* (1789).<sup>356</sup> However, in *Williams v Everett*, the court treated the bailee’s assent as part of the broader ‘privity’ required to exist between the bailee and the beneficiary.<sup>357</sup> Subsequent case law took this ‘privity’ to mean an agreement between the bailee and beneficiary. More specifically, even mere ‘attornment’ by the bailee to the beneficiary did not suffice; rather, a binding contract supported by ‘consideration’ must have existed between them, created by the offer of the bailee to pay the beneficiary, and accepted by the beneficiary’s

<sup>350</sup> For an extensive discussion of the broader context of *Assumpsit* and the doctrine of consideration, see Simpson, above n 2 at 406–88. The privity aspect is discussed *ibid* at 475–88.

<sup>351</sup> See text and nn 144–66 above.

<sup>352</sup> (1811) 14 East 582, 104 E.R. 725.

<sup>353</sup> See eg Stoljar, *History*, above n 292 at 141.

<sup>354</sup> *Ibid*.

<sup>355</sup> The requirement for the bailee’s agreement is explained in text that follows n 96 above.

<sup>356</sup> Above n 142.

<sup>357</sup> Above n 352 at 597 (East), 731 (E.R.) (per Lord Ellenborough).

release of the bailor.<sup>358</sup> Such a binding contract, but not an actual promise made by the bailee to the beneficiary, was dispensed with when the bailee was a holder of actual assets or ‘funds’ belonging to the bailor.<sup>359</sup> Under such circumstances the beneficiary became entitled to a remedy in money had and received, effectively to enforce the bailee’s promise to pay either the fund<sup>360</sup> or out of the fund.<sup>361</sup> Overall, case law was not consistent, and in any event, in imposing privity requirements for a remedy in money had and received, it turned nineteenth-century law relating to the bailment of money into ‘an intractable mass of conflicting authority.’<sup>362</sup> For our purposes, suffice it to say that, in requiring a promise made by the bailee to the beneficiary, this case law arrested the evolution of any convergences between the Medieval law of bailment of money and the law of bills of exchange along lines introducing to English law a concept analogous to the French *provision*.

To a large extent, this process of disintegration of the Medieval legal doctrine governing the bailment of money highlights the importance of the bailee’s consent in according the beneficiary a remedy against him. Thus, in the early Medieval cases, the bailee’s receipt of the money delivered to him by the bailor to the use of the beneficiary sufficed to entitle the beneficiary to sue the bailee, first in Account and subsequently also in Debt.<sup>363</sup> Subsequently it was held that it made no difference whether the money had physically been delivered to (and received by) the bailee for the use of the beneficiary, or whether the bailor instructed the bailee to direct, to the use of the beneficiary, money already held by him (the bailee) for the bailor.<sup>364</sup> Logically, a remaining issue as to the bailee’s assent inuring to the benefit of the beneficiary was whether such assent could be premised on, or relate back to, an agreement given by the bailee to the bailor to apply the bailor’s money in his (the bailee’s) hands as instructed (by the bailor). An affirmative answer would have entitled a payee to claim directly from a depositary instructed by the depositor to pay the payee out of the deposit, provided of course that the depositary had agreed in advance with the depositor to comply with the depositor’s instructions, as is usual under a standard bank account contract.<sup>365</sup> However, in requiring privity in the form of a direct agreement between the bailee/depositary and the beneficiary/payee, so that under no

<sup>358</sup> *Wharton v Walker* (1825) 4 B. & C. 163, 107 E.R. 1020.

<sup>359</sup> Granted, this distinction is very subtle. Possibly, a depositary of money delivered to him by the bailor is a fund holder, while one who owes money to the bailor on the basis of some contract between them is a mere debtor.

<sup>360</sup> See eg *Liversidge v Broadbent* (1859), above n 342.

<sup>361</sup> *Griffin v Weatherby* (1868) L.R. 3, Q.B. 753.

<sup>362</sup> Jackson, above n 2 at 99. This development is extensively discussed eg by Jackson, *ibid* at 93–103; JD Davies, ‘*Shamia v Joory*: A Forgotten Chapter in Quasi-Contract’ (1959), 75 *LQR* 220; Stoljar: *History*, above n 292 at 140–43; and R Goff and G Jones, *The Law of Restitution*, 7th edn (London: Sweet & Maxwell, 2007) at 693–97.

<sup>363</sup> See section 3, particularly text and nn 98–139 above.

<sup>364</sup> See text that follows n 142 (per *Israel v Douglas* (1789), above n 142).

<sup>365</sup> The promise to repay deposited or collected funds as instructed by the customer is of the essence to the bank account agreement. See *Joachimson v Swiss Bank*, above n 285 at 127.

circumstances would the bailee's consent given to the bailor suffice, the common law did not even give itself a chance to address the requirements for the consent of the beneficiary under the Medieval law of the bailment of money.

## 6. CONCLUSION

Late Medieval common law allowed a bailor of money to sue the bailee; thereby it laid down the basis for the present debt relationship between a bank (bailee) and a customer (bailor) on the bank deposit. Furthermore, in the course of the seventeenth century, the common law of England facilitated actions (i) by the payee against the acceptor of a bill of exchange as well as (ii) by the beneficiary against the bailee of money received by the bailee from a bailor to the use of the beneficiary. The payee's action on the bill of exchange was in *Assumpsit* and the beneficiary's action against the bailee was in Debt. Both actions were allowed notwithstanding lack of privity between the plaintiff and defendant.

The dispensation of privity for the payee/beneficiary was a unique and distinguishing feature of the legal theory underlying both facilities. Thus, by reference to terminology used both for these payment mechanisms and the generic model presented in chapter one, section 4 above, suppose there is a payment instruction by the debtor/drawer/bailor to paymaster/drawee/bailee (who holds his funds) to pay the creditor/payee/beneficiary. The operation of both the bill of exchange and the late Medieval bailment of money as payment mechanisms is premised on the agreement of the paymaster/drawee/bailee with the debtor/drawer/bailor. This basis is in contrast with the theory underlying the Roman law delegation<sup>366</sup> and Hanafi *hawale*;<sup>367</sup> both require the agreement of the creditor/payee/beneficiary with the paymaster/drawee/bailee.

The dispensation of privity under the legal theory of the bill of exchange and Medieval bailment of money is also in contrast with the theory underlying the cession or assignment of debts,<sup>368</sup> as well as the Maliki *hawale*,<sup>369</sup> which requires the agreement of the creditor/payee/beneficiary with the debtor/drawer/bailor.

Being premised on the agreement of the paymaster/drawee/bailee with the debtor/drawer/bailor, the theory underlying the bill of exchange and the bailment of money bears some similarity to the Talmudic *zech*i. In relation to a deposit, the latter is a command given by the depositor conveying authority to acquire, so as to benefit a transferee, by effectively appointing the custodian to carry out on behalf of the depositor, a proprietary act required for the transfer of deposit.<sup>370</sup> But while *zech*i is an unpopular facility requiring some formality,<sup>371</sup>

<sup>366</sup> See ch 5, section 6 above.

<sup>367</sup> See ch 6, section 2 above.

<sup>368</sup> See ch 5, section 9 above.

<sup>369</sup> See ch 6, section 2 above.

<sup>370</sup> See ch 7, section 2.2 above.

<sup>371</sup> *Ibid.*

the bill of exchange and the bailment of money are informal and hence fared substantially better in terms of use and impact.

However, over the centuries, privity had become an issue, particularly in *Indebitatus Assumpsit*. As a result, an undesirable by-product of the seventeenth-century take-over of Debt by *Indebitatus Assumpsit* was the loss to the beneficiary of his action against the bailee for money delivered to the bailee by a bailor, unless beneficiary and bailee reached their own direct agreement. This state of law materialized in the course of the nineteenth century. It made the operation of bailment of money premised on the same basis as that of the Roman law delegation and Hanafi *hawale* which, as pointed out in the previous paragraph, require the agreement of the creditor/payee/beneficiary with the paymaster/drawee/bailee. At the same time, not being theorized under *Indebitatus Assumpsit*, the payee's right against the acceptor of the bill of exchange remained intact, albeit, arguably, its own theoretical basis had become somewhat obscure.

As of the late nineteenth century, English law has allowed for a 'statutory' or 'legal' assignment of debts. Such an assignment must be absolute, in writing, and for which notice has been given to the debtor.<sup>372</sup> It is required to be for the entire debt.<sup>373</sup> Equitable assignment, which could be for only a part of the debt, and for which only an informal agreement between the assignor and assignee is required, has been available all along.<sup>374</sup> However, debt assignment has not become a popular substitution as an underlying theory for the bailment of money.<sup>375</sup> Two principal reasons for this could be speculated. First, the background of the legislative rejection of the assignment theory for the bill of exchange<sup>376</sup> may have served as a deterrent. Second, the complexity of modern banking, with multiple banks that may be involved in one funds transfer,<sup>377</sup> may make the application of the assignment theory difficult. At the same time, with the demise of its underlying legal theory, being premised on the bailor-bailee's agreement, the bailment of money ceased to exist as a mechanism for the transfer of funds.

As will be seen in chapter ten below, while on its own the bill of exchange became a credit facility more than a payment mechanism, it bestows its features on the cheque, so as to leave a significant heritage to the law of funds transfers. However, for its part, the law of bills of exchange has not provided for a model law governing all aspects of funds transfer. While being more sophisticated than

<sup>372</sup> The original statute is the *Supreme Court of Judicature Act*, 1873 (UK), 36 & 37 Vict., c. 66.

<sup>373</sup> See *In re Steel Wing Co* [1921] 1 Ch. 349.

<sup>374</sup> See last paragraph of section 1 above. The same substantive rights are conferred on an assignee by equitable and statutory assignments.

<sup>375</sup> A leading modern case to that effect is *Libyan Arab Foreign Bank v Banker's Trust Co* [1988] 1 Lloyd's Rep. 259 (Q.B.) at 273, specifically rejecting 'dicta in one American case' to the contrary, apparently from *Delbrueck v Manufacturers Hanover Trust Co* 609 F.2d 1047 (2nd Cir. 1979) at 1051.

<sup>376</sup> See text and n 343 above.

<sup>377</sup> See eg HS Scott, 'Where Are the Dollars? – Off-Shore Funds Transfers' (1988–89), 3 *Banking and Finance Law Review* 243, 252–63.

the law relating to the bailment of money, the law of bills of exchange has not satisfactorily and comprehensively regulated all aspects of the funds transfer. As well, the law of bills of exchange did not purport to embrace all types of payment mechanisms. Rather, insofar as it was concerned with funds transfer, it was limited to the bill of exchange itself.<sup>378</sup> In the final analysis, a convergence with the law of the bailment of money, as it stood before the nineteenth century, would have provided improvements to both the law of bills of exchange and that of funds transfers.

<sup>378</sup> Its concern with the negotiability features of the bill of exchange undoubtedly expanded to other instruments, eg, the promissory note.

# Evolution and Transformation: The Birth of the Modern Payment System in Post-Medieval England

|                                                                                                        |     |
|--------------------------------------------------------------------------------------------------------|-----|
| 1. Introduction                                                                                        | 467 |
| 2. The Goldsmiths' System: Banknotes, Cheques, and Banking Network                                     | 469 |
| 2.1 Introduction                                                                                       | 469 |
| 2.2 Goldsmith Banking Operations: Notes, Cheques and Bill Discounting                                  | 471 |
| 2.3 Goldsmith Banking System: The Network                                                              | 481 |
| 3. Bank of England: Note Issue, Cheque Settlement and Central Banking                                  | 484 |
| 3.1 Introduction                                                                                       | 484 |
| 3.2 Bank of England Notes                                                                              | 487 |
| 3.3 Bank of England Becomes a Settlement Bank                                                          | 492 |
| 3.4 Bank of England Becomes a Central Bank                                                             | 497 |
| 4. Paper Money and the Promise to Pay Money: Are Banknotes<br>'Promissory Notes'?                      | 505 |
| 5. Gold Reduced to Paper and Entries to Accounts: Metallism,<br>Nominalism, Paper Money and Bank Money | 518 |

## 1. INTRODUCTION

IF, FOLLOWING ANCIENT Greece,<sup>1</sup> Italy gave rise to banks,<sup>2</sup> it was England that gave rise to a banking system. The latter is a network of independent private bankers linked to each other in a system facilitating, on a regular basis, interbank payments and ongoing reciprocity. In the early post-Medieval era (roughly from the seventeenth to the nineteenth century inclusive), an English model for banking evolved in London. This model heralded the current framework for commercial banking<sup>3</sup> as well as the architecture

<sup>1</sup> As discussed in ch 3, section 3 above.

<sup>2</sup> As discussed in ch 8, section 2 above.

<sup>3</sup> Throughout this chapter, 'commercial banking', 'private banking', 'deposit banking' (other than, where applicable, in the more specific medieval connotation as discussed in ch 8 above) and even 'banking' are used interchangeably, and are to be distinguished particularly from central banking, discussed further below in this chapter.

and institutional framework for the modern payment system. It also put in place the design of the present monetary system, namely the operational and institutional framework under which money is issued and becomes available for use by participants in the payment system.

From its early years, the English model evolved as an improvement to its Continental counterpart in several major respects.

First, it involved private players who combined deposit banking and bills of exchange dealings. These players started the practice of discounting bills of exchange. This practice, together with note-issuing, contributed to the provision of liquidity, enhanced diversification and expanded business. In the process, the core of 'commercial banking' activity became the financial intermediation between savers/depositors (lenders to the banker) and borrowers from the banker.

Second, the operation of the English banking system heavily relied on close correspondent relationships among participating private bankers who provided support to each other. An element facilitating the establishment of a common infrastructure was added to complement, though not to replace, competition.

Third, in the footsteps of the second improvement, by extending credit to each other, bankers became positioned to develop a truly national banking and interbank cheque system. Both the second and third features facilitated specialization in information-intensive, non-traded loans, which became a principal niche for a profitable commercial banking business as well as effective financial intermediation for the economy as a whole. In providing such loans, as well as in issuing banknotes and discounting bills of exchange, English bankers came to provide a reliable source of liquidity to the economy.

Fourth, and again in the footsteps of the second improvement, interbank co-operation gave birth to a common institution, in the form of a clearinghouse. This allowed risk reduction, enhanced efficiency, and generated common services that facilitated further development.

Finally, a central bank was established. Ultimately, the central bank would completely supersede the earlier Continental public bank. In the post-Medieval era, this new participant complemented private commercial banks without competing with or becoming a substitute for them. Rather, the central bank strengthened private bankers in two major ways. First, it furnished them with a source of liquidity emanating from the central bank as a lender of last resort. Second, it provided them with the efficiency of multilateral settlement in reserve accounts held with the central bank. In both ways, the central bank has come to be an integral part of the private bank network referred to in the previous paragraphs. English central banking further established the banknote as the standard monetary object, so as effectively to substitute and supersede the coin altogether.

This improved system, containing all those elements, evolved in England during the seventeenth to the nineteenth centuries, and developed into a conduit for both the monetary and payment systems. As for the monetary system, it laid the foundation for the use of the banknote as the standard monetary object. It also transformed 'bank money'; the latter is money on deposit with banks, in the



form of credit to bank accounts, which is transferred from one person to another, within and outside a country, by means of payment mechanisms initiated by payment orders. With the capability to discharge debts, such credit to bank accounts has become, on its own, a type of 'money'. In initiating a transfer of monetary value under a payment mechanism, as discussed above in chapter one, section 4, the payment order thus emerged as a vehicle for generating 'money' itself. As for the payment system, developments in England gave rise to the cheque system and to interbank clearing.

Undoubtedly, like the banknote and in fact 'banking' and even 'bank money', neither the cheque nor the multilateral framework for payment clearing was invented in post-Medieval England. At the same time, it is the creation of a broadly based system using these instruments and institutions, on which a massive global commercial and financial enhancement relied, which certainly goes back to post-Medieval England.

Indeed, the post-Medieval developments in England set the tone for the future design of banking as well as for both monetary and payment systems all over the world. For its part, in using Medieval instruments and institutions as building blocks for systems, transformation and growth, the entire process in England required both facilitation by and adaptation of legal doctrine on which this study focuses. This chapter examines the post-Medieval developments in England, facilitating growth and transformation, as well as legal issues arising in connection with new instruments generated in the process. Legal doctrine that evolved to facilitate the process as a whole is discussed in chapter eleven. For its part, chapter twelve highlights pertinent aspects of modern law as a natural outgrowth of the post-Medieval developments.

The ensuing discussion in this chapter explores the goldsmith bank system that gave rise to cheques and banknotes (section 2); the establishment of the Bank of England and its transformation to a central bank (section 3); the legal nature of the banknote, particularly as a promissory note (section 4); and concludes with an overview on the evolution of money in the context of the birth of the modern payment system in the process described above (section 5). In this process of both transformation and continuity, the nature of credit in a bank of account evolved to encompass both the object of a payment mechanism, whose operation is initiated by a payment order, and a type of 'money'.

## 2. THE GOLDSMITHS' SYSTEM: BANKNOTES, CHEQUES, AND BANKING NETWORK

### 2.1 Introduction

The English post-Medieval banking system evolved gradually.<sup>4</sup> As for Medieval origins, both close commercial contact with the Continent and the arrival of

<sup>4</sup> For a succinct summary, see W Holdsworth, *A History of English Law*, 2nd edn (London: Methuen, Sweet & Maxwell, 1937, reprint 1966) vol VIII at 185–92.

Jewish money lenders as first financiers are associated with the Norman Conquest of 1066.<sup>5</sup> During the late Middle Ages, London became part of the Medieval exchange banking landscape.<sup>6</sup> Exchange bankers were Italian,<sup>7</sup> who became principal financiers of the Crown,<sup>8</sup> particularly after the expulsion of the Jews by King Edward I in 1290.<sup>9</sup> At the same time, the business of deposit banking, in the sense of borrowing in order to lend, was first carried on in England,<sup>10</sup> during the later part of the sixteenth and early part of the seventeenth centuries, by domestic players, the scriveners; they were scribes whose principal business had been to act as notaries, viz to draft legal documents.<sup>11</sup> Being trusted intermediaries in commercial and financial transactions, the scriveners expanded into deposit taking and lending.<sup>12</sup> Nonetheless, neither paper money nor payment mechanisms were instituted by them.<sup>13</sup>

English banknotes as paper money and cheques as payment mechanisms originated in the early post-Medieval era with the transformation of some gold-

<sup>5</sup> See JB Martin, *'The Grasshopper' in Lombard Street* (New York: Burt Franklin, 1968, originally published: London, 1892) at 112. For further discussion of the Jews' position, particularly as financiers and money lenders, in the first centuries after the Norman Conquest of England, see F Pollock and FM Maitland, *The History of English Law Before the Time of Edward I*, rev 2nd edn (Cambridge: Cambridge University Press, 1968) vol I at 468–75.

<sup>6</sup> As pointed out above in ch 8, section 3 (quote in text that follows n 123), De Roover includes London in his list of European banking centres in the fourteenth and fifteenth centuries. R De Roover, 'New Interpretations of the History of Banking' in J Kirshner (ed), *Business, Banking, and Economic Thought in Late Medieval and Early Modern Europe: Selected Studies of Raymond de Roover* (Chicago and London: University of Chicago Press, 1974, Phoenix Edition 1976) at 205 (hereafter: De Roover, 'New Interpretations'). Neither the English involvement in the transformation of the letter of payment into a bill of exchange (discussed in ch 8, section 5 above) nor the 'reception' of the bill of exchange by English law (discussed in ch 9, section 4 above) is to be discussed in this chapter.

<sup>7</sup> De Roover, *ibid* at 230, see also R De Roover, 'What is Dry Exchange?' in J Kirshner, *ibid*, 183 at 184 (hereafter: De Roover, 'Dry Exchange'). Exchange bankers in London were known as 'remitters'. See 'Banking' in J Savary (ed), *The Universal Dictionary of Trade and Commerce*, 2nd edn, trans by M Postlethwayt (London: John Knapton, 1757) vol I at 193, 197.

<sup>8</sup> For an extensive review, see M Prestwich, 'Italian Merchants in Late Thirteenth and Early Fourteenth Century England' in Centre for Medieval and Renaissance Studies, University of California, Los Angeles (ed), *The Dawn of Modern Banking* (New Haven and London: Yale University Press, 1979) at 77.

<sup>9</sup> For the Edict of Expulsion (and its revocation in 1656) visit [www.en.wikipedia.org/wiki/Edict\\_of\\_Expulsion](http://www.en.wikipedia.org/wiki/Edict_of_Expulsion).

<sup>10</sup> But cf Prestwich, above n 8 at 95, arguing that '[a]s bankers, the Italian companies naturally received deposits', albeit, only to concede immediately (*ibid* at 96–97) that this was mostly done for the purpose of the transmission of funds and foreign exchange.

<sup>11</sup> For scriveners as the pioneers of deposit banking in England who preceded the goldsmiths, see eg RD Richards, *The Early History of Banking in England* (New York: AM Kelley, 1965, reprint of 1929 edition) at 15–18 (hereafter: Richards, *Early History*). Another London actor as a financial intermediary, albeit with no claim to ancestry of banking, was the broker, from which subsequently emerged the jobber and bullion dealers. *Ibid* at 2, 14. For the wool 'brogger' and the corn 'bodger' as early bankers or financiers, see *ibid* at 18–19.

<sup>12</sup> Richards, *Early History*, *ibid* at 15. On the scriveners, in the broader context of a historical study on the origins of English deposit banking, see FT Melton, *Sir Robert Clayton and the Origins of English Deposit Banking, 1658–1685* (Cambridge: Cambridge University Press, 1986) at 40–94.

<sup>13</sup> See JM Holden, *The History of Negotiable Instruments in English Law* (London: University of London: The Athlone Press, 1955, rep. 1993, WM. W. Gaunt & Sons) at 205–06.

smiths to bankers. Indeed, it may well be that 'multitude of sources' fed the stream that became 'English banking'; and yet to say they 'merely supplied one tributary to [that] stream'<sup>14</sup> belittles their contribution. In introducing to England the banknote and cheque, and taking over and transforming the bills of exchange business, the goldsmiths not only 'monopolized' private banking as a separate business;<sup>15</sup> rather, they created a new banking model, and thereby shaped the precursor to the current design of the banking system worldwide.<sup>16</sup>

## 2.2 Goldsmith Banking Operations: Notes, Cheques and Bill Discounting

For the sake of precision, some qualifications are required. Admittedly, both cheques and paper money<sup>16.1</sup> are not of English ancestry. Nor did the endorsement of the bill of exchange originate in England. Thus, as already indicated above in section 5 of chapter three, cheques are traced back to the first century BCE Greco-Roman, or more specifically to Ptolemaic, Egypt, and subsequently, as indicated above in section 2 of chapter eight, to Medieval Continental Europe, or more specifically, to Italy of the fourteenth and fifteenth centuries. True, cheques from both places and periods were non-transferable but, nonetheless, they were cheques. Regardless, as also indicated above in section 2 of chapter eight, transferable cheques go back to early post-Medieval Amsterdam, to a period that may slightly precede, but essentially paralleled, that of their emergence in England. Also, as further pointed out in chapter eight, section 5, endorsed bills can be traced in the Continent to the early sixteenth century.

For its part, the invention of paper money is attributed to the Chinese. Marco Polo reported to Europe on this invention in the course of the thirteenth century; accordingly, Davies singles out paper money as the only possible exception to the lack of Chinese direct influence on Western monetary history. This lack of direct Chinese influence, from which paper money is excepted, is attributed to the lack of contact between the two civilizations until the modern era.<sup>17</sup> According to Toynbee, the feasibility of paper money is thus 'associated with

<sup>14</sup> As in fact argued by RH Tawney, *Historical Introduction to T Wilson, A Discourse Upon Usury [1572]* (New York: Harcourt Brace, 1925) at 101.

<sup>15</sup> For 'banking' in England as 'eventually monopolized by the goldsmiths', see Holdsworth, above n 4 at 185.

<sup>16</sup> Arguably then, Tawney, above n 14, is to be taken to refer to the goldsmiths' role in shaping financial intermediation as a whole, and not strictly speaking 'banking', the latter being the financial intermediation between depositors-savers and borrowers.

<sup>16.1</sup> 'Paper money' is used here to denote money consisting of monetary objects made of materials whose value does not purport to bear any relationship to the monetary value of the object. Historically such material has been predominantly but not exclusively paper. For a trend for the 'conversion' to plastic in Australia, New Zealand, Mexico and most recently Canada, see eg [cnews.canoe.ca/CNEWS/Canada/2010/03/05/13131881-qmi.html](http://cnews.canoe.ca/CNEWS/Canada/2010/03/05/13131881-qmi.html) (Bank of Canada March 5, 2010). For our purposes the emerging plastic banknote is a species of paper money.

<sup>17</sup> G Davies, *A History of Money From Ancient Times to the Present Day*, 3rd edn (Cardiff: University of Wales Press, 2002) at 55–58, 178–84.

the two Sinic inventions of paper and printing' that culminated in the issue of paper money by the Sung Government in 970 CE.<sup>18</sup>

There are, however, variations on some details of this account of the Chinese paper-money. According to Eagleton and Williams, during the Song dynasty (960–1279 CE), the facilitation of inter-regional trade and the heavy weight of iron coins prompted the private issue and country-wide circulation of short-term (time-limited) 'certificates of accounts' or 'exchange notes'. In 1189 CE the Jin issued circulating official Exchange Certificates with no expiration date. During the Mongol Yuan dynasty (1206–1367 CE) paper money was used exclusively, as the circulation of gold, silver, and copper coins was prohibited. Paper money was successfully forced by the Mongols into Korea but not into Iran.<sup>19</sup> Nonetheless, Davies opines that 'the most celebrated experiment, which brought knowledge of the Chinese system much closer to the West, was that in the kingdom of Persia in 1294.' Its experiment in the city of Tabriz lasted only two months and was 'a complete disaster'. At the same time, this was 'the first recorded instance of block printing outside China' of which the West possibly learnt.<sup>20</sup> In fact, as was already pointed out above in chapter eight, section 2, 'Europe's first freely circulating banknotes' were issued in the middle of the seventeenth century by the public bank in Sweden.<sup>21</sup>

At the same time, as an innovative financial practice, bill-discounting, while premised on the endorsement which is of earlier Continental origin, is the creation of goldsmith bankers. As well, for their part, the re-emergence of cheques and paper money in post-Medieval England was not tantamount to the re-invention of the wheel. True, as stand-alone instruments and mechanisms, they were not new. However, in the English model, both instruments were innovations in that the cheque was transferable and paper money was firmly linked to banking. Moreover, these instruments evolved in England in the context of the creation of a national banking system. That system developed to provide effective financial intermediation. It further evolved to serve as a model for the design of national banking, monetary, and payment systems around the world. It is for the re-emergence, or more precisely, re-invention, of these instruments in this context, that credit is attributed to England. A major innovation then is the design and architecture of the system that gave rise to the re-emergence of these instruments.

<sup>18</sup> AJ Toynbee, *A Study of History: Abridgement of Volumes VII–X* by DC Somervell (London: Oxford University Press, 1957) at 62.

<sup>19</sup> C Eagleton and J Williams, *Money: A History*, 2nd edn (London: British Museum Press, 2007) at 149–50. According to Marco Polo (as quoted, *ibid* at 149), worn out notes issued during the Mongol Yuan dynasty could be replaced by holders at the mint for new ones at a discount of three per cent.

<sup>20</sup> Davies, above n 17 at 183. His own account of the Chinese history is *ibid* at 178–84.

<sup>21</sup> Eagleton and Williams, above n 19 at 179, and in more detail: I Wiséhn, 'Sweden's Stockholm Banco and the first European banknotes' in V Hewitt (ed), *The Banker's Art: Studies in Paper Money* (London: British Museum Press, 1995) at 12.

This is, however, not to dismiss or undervalue the effect of the 'mere' re-invention of the instruments. First, it is possible that before this, in the East, the acceptance of paper money by the public had been a mere function of fear of the ruler's sanction;<sup>22</sup> conversely, in the West, while ultimately backed by law, acceptance of paper money was voluntary and, in fact, of mercantile origin, designed to save the cost of assaying, storing and safekeeping coins. Second, as 're-invented' by the goldsmith, both cheques and banknotes significantly affected both law and finance. Indeed, with the advent of electronic banking, the exclusivity of both the cheque as a non-cash payment mechanism and the banknote as a cash payment object has been challenged. However, their legal framework, for the cheque as a payment mechanism and for the banknote as both an obligation to pay and a means of payment on its own, left a distinct mark on the entire legal thinking of both cash and non-cash payments. As well, both instruments' coverage by, and impact on, the law of negotiable instruments provided a major contribution of its own to that area of law. Also, in the final analysis, unlike elsewhere, in their Renaissance English version, cheques and banknotes were not passing phenomena. Rather, they came to stay and spread out to the entire globe as part of the monetary and banking design of which they are part and with which we are familiar in the modern era.

Cheques and banknotes in England go back to the goldsmiths.<sup>23</sup> Until the Civil War, during the last decade of the first half of the seventeenth century,<sup>24</sup> 'the goldsmiths' business had consisted chiefly of the manufacture of gold and silver plate and jewellery and the purchase, mounting and sale of jewels.'<sup>25</sup> It is in this capacity as experts in precious metals that they first became involved in money; since 1248 'to this day', the Goldsmiths' Company of London has been 'the official arbiter of the purity of British coinage.'<sup>26</sup> Already before the Civil War, goldsmiths accepted 'money and plate in trust'<sup>27</sup> and became gradually involved in the money business.<sup>28</sup> They dealt with money change and, taking advantage of 'the bad state of the coinage in the seventeenth century', they profited from 'culling out . . . heavier weighted coins from circulation and melting

<sup>22</sup> For this explanation for the success of the Mongols and failure in Persia, see eg M Manning, E Nier and J Schanz (eds), *The Economics of Large-value Payments and Settlement: Theory and Policy Issues for Central Banks* (Oxford: Oxford University Press, 2009) at 21.

<sup>23</sup> But cf JK Horsefield, *British Monetary Experiments, 1650–1710* (Cambridge, Mass: Harvard University Press, 1960) at 93–217, canvassing earlier and parallel experimentation in note issuing and other forms of paper money.

<sup>24</sup> The English Civil War (1641–1651) was a series of armed conflicts and political machinations between Parliamentarians and Royalists. See eg [www.en.wikipedia.org/wiki/English\\_Civil\\_War](http://www.en.wikipedia.org/wiki/English_Civil_War).

<sup>25</sup> Holden, above n 13 at 71, fn 2.

<sup>26</sup> Davies, above n 17 at 146. As of 1282, the purity of British coinage is tested in the 'Trial of the Pyx' carried out by 'a public jury of "twelve discrete and lawful citizens of London with twelve skilful Goldsmiths"'. *Ibid.*

<sup>27</sup> See Richards, *Early History*, above n 11 at 35. See also Holdsworth, above n 4 at 185.

<sup>28</sup> However, there may be no unanimity as to the transition; according to WJ Lawson, *History of Banking*, 2nd edn (London: Richard Bentley, 1855) at 215, 'in modern phraseology', the early monetary business of the goldsmith 'is better known by the name of pawnbroker.'

them down into bullion.<sup>29</sup> During the Civil War, an era of increased risk and insecurity as well as decline in merchants' confidence in financial dealings with the Crown,<sup>30</sup> they started to receive money for safekeeping.<sup>31</sup> Soon, during the Cromwellian period, at the beginning of the second half of the seventeenth century,<sup>32</sup> the goldsmith turned into a banker. Having acted until then as bailee or custodian of money in trust, or in fact, a custodian of money for safekeeping,<sup>33</sup> he came to accept deposits with full authority to make use of deposited money by lending it to others.<sup>34</sup> Certainly, the process was gradual and did not apply to all goldsmiths; over time, 'a clear distinction emerged between the 'working goldsmiths', and the 'exchanging goldsmiths' from which latter group the true bankers typically emerged.'<sup>35</sup> It is the latter category, of goldsmiths turned deposit bankers, which is of interest in this study.

The exchange goldsmiths 'began to keep "running cash" for the convenience of merchants and the country gentlemen.'<sup>36</sup> As latecomers to a then already phased-out international exchange business,<sup>37</sup> they do not appear to have contributed to the development of its practice.<sup>38</sup> Rather, with the advent of the

<sup>29</sup> JS Rogers, *The Early History of the Law of Bills and Notes: A Study of the Origins of Anglo-American Commercial Law* (Cambridge: Cambridge University Press, 1995) at 119 (hereafter: Rogers, *Bills and Notes*). That is, they drove out of circulation coins whose metallic value was higher than others of the same denomination.

<sup>30</sup> Certainly confidence was shattered upon King Charles I's 'forcible loan' of specie kept in the Tower in 1640. It is alleged that the money borrowed was on deposit made by merchants. Holden, above n 13 at 70–71; Richards, *Early History*, above n 11 at 35; Holdsworth, above n 4 at 187, as well as Martin, above n 5 at 117. But according to Rogers, *ibid* at 118, the incident involved a delay in delivering coins made of precious metal imported from the New World. This is also the version of PW Matthews, *The Bankers' Clearing House: What it Is and What it Does* (London: Pitman & Sons, 1921) at 5.

<sup>31</sup> Rogers, *ibid* at 119.

<sup>32</sup> After the execution of King Charles I in 1649, Oliver Cromwell (1599–1658) dominated the short-lived Commonwealth of England, conquered Ireland and Scotland, and ruled as Lord Protector from 1653 until his death in 1658. See eg [www.en.wikipedia.org/wiki/Oliver\\_Cromwell](http://www.en.wikipedia.org/wiki/Oliver_Cromwell).

<sup>33</sup> It is likely that he was never a bailee of specific coins. A custodian of money for safekeeping was not allowed to use the money, but inasmuch as he was not required to return to each depositor the specific coins originally delivered to him for safekeeping, or to keep them separately, he was not liable in Detinue. The nature of the custodian's liability to the depositor, whether in Debt or Account, 'was never really settled in medieval law.' AWB Simpson, *A History of the Common Law of Contract: The Rise of the Action of Assumpsit* (Oxford: Clarendon Press, 1975) at 183. See ch 9, text around n 35 above. But see A Feavearyear, *The Pound Sterling – A History of English Money*, 2nd edn by EV Morgan (Oxford: Clarendon Press, 1963) at 102 speaking of the goldsmith as a custodian of money acting 'just as a modern safe-deposit company would do' today, which suggests physical segregation of money deposited by each depositor.

<sup>34</sup> Richards, *Early History*, above n 11 at 37.

<sup>35</sup> Davies, above n 17 at 250. Davies' account of '[t]he rise of the goldsmith-banker, 1633–1672' is set out in *ibid* at 248–52. For the distinction between the working and exchanging goldsmiths, see also Richards, *Early History*, *ibid* at 36.

<sup>36</sup> De Roover, 'Dry Exchange', above n 7 at 184–85.

<sup>37</sup> The decline of the exchange business is discussed in ch 8, section 5 above.

<sup>38</sup> Indeed, while De Roover, 'Dry Exchange', above n 7 at 184 speaks of the goldsmiths 'merging' deposit and exchange banking; in fact, they got involved in exchange banking only to transform it to bill-discounting banking.

inland bill of exchange,<sup>39</sup> and the relaxation of usury laws,<sup>40</sup> they began to discount, first, inland bills of exchange and, subsequently, albeit not until the later part of the eighteenth century, foreign ones.<sup>41</sup> Thus, a payee of a term bill of exchange, drawn on the drawer's factor or buyer, could obtain finance by endorsing the bill and obtaining its present value. In the case of a sale of goods, the bill could have been made payable by the drawer-seller to himself, so as to be able to obtain its present value shortly after the shipment of the goods before their resale by the buyer. Value could have been obtained against such 'trade bills' even prior to acceptance, against the endorsement of the payee, or after acceptance, also against the credit of the accepting drawee.<sup>42</sup> This method of financing the sale of goods between distant parties proliferated in the nineteenth century,<sup>43</sup> and has survived to the present day.<sup>44</sup>

Gradually, the goldsmith banker became a financial intermediary. Moreover, as will be explained at the end of this section, credit extension was in the form of providing to its customers (namely, depositors) information-intensive non-traded loans. By taking deposits, lending out of them, allowing depositors to draw cheques on them, issuing banknotes, and discounting bills of exchange (as well as promissory notes as further discussed below), the goldsmith thus became the precursor to the modern banker.<sup>45</sup> For some time, in fact far into the nineteenth century, though having become by then in England the exclusive domain of a central bank,<sup>46</sup> note issuing was the principal characteristic of 'banking'.<sup>47</sup>

<sup>39</sup> *Ibid*, as well as ch 9, section 4 above. See also Richards, *Early History*, above n 11 at 46.

<sup>40</sup> For this factor in the development of the discount practice see eg R De Roover, *L'Evolution de la Lettre de Change XIVe–XVIIIe Siècles* (Paris: Librairie Armand Colin, 1953) at 119–42. For the relaxation of usury laws as of the sixteenth century in England see: N Jones, *God and the Moneylenders: Usury and the Law in Early Modern England* (Oxford: Basil Blackwell, 1989).

<sup>41</sup> De Roover, 'Dry Exchange', above n 7 at 184–85, and De Roover, 'New Interpretations', above n 6 at 230–31. De Roover draws a distinction between the *discount* of inland bill and the *negotiation* of foreign bill. However, he specifically relies on Postlethwayt's translation of Savary, above n 7 at 197, who in relation to a foreign bill of exchange, drawn by a foreign 'remitter' in a traditional exchange transaction, appears to use 'negotiation' interchangeably with the 'issue' of the bill.

<sup>42</sup> For a detailed analysis see Rogers, *Bills and Notes*, above n 29 at 100–24. See also P Temin, 'Financial Intermediation in the Early Roman Empire' (2004), 64 *Journal of Economic History* 705 at 713–14.

<sup>43</sup> A point noted by N Ferguson, *The Ascent of Money* (New York: Penguin Press, 2008) at 53.

<sup>44</sup> See eg W Baker and JF Dolan, *User's Handbook for Documentary Credits under UCP 600* (Paris: ICC, 2008), describing at 37–42 step by step the documentary draft transaction. See also A Mugasha, *The Law of Letters of Credit and Bank Guarantees* (Annadale and Leichhardt, NSW, NSW: Federation Press, 2003) at 6–9.

<sup>45</sup> A point noted by Martin, above n 5 at 129.

<sup>46</sup> See section 3.2 below.

<sup>47</sup> See eg Rogers, *Bills and Notes*, above n 29 at 117. For the US (in the absence of a central bank during the nineteenth century), see extensive discussion by G Tucker, *The Theory of Money & Banks Investigated* (New York: AM Kelly, 1964, reprint of 1839 original) at 145–90, distinguishing between nineteenth-century 'circulation banks' in Great Britain and the US, that issue notes, and the earlier Continental 'deposit banks' (discussed in this book in ch 8, section 2 above) that did not. See also the constitutional position in Canada, set in the nineteenth century, where under the *British North America Act, 1867* (now *Constitution Act, 1867* (UK), 30 & 31 Vict., c. 3, reprinted in R.S.C. 1985, App. II, No 5)), 'Banking, incorporation of banks, and the issue of paper money' under s 91(15) constituted a heading of legislative power separate from that of 'Currency and coinage'



Notes were issued by banks either against deposit of specie, that is, precious metal or coins, or against the negotiation, and hence in discount, of bills of exchange, as well as of promissory notes.<sup>48</sup> In Scotland, they were also issued during the eighteenth century in connection with overdraft facilities guaranteed by sureties.<sup>49</sup> Legal issues pertaining to promissory notes, discount, and negotiability are discussed below in chapter eleven; the banknote and cheque are introduced immediately below.

Goldsmiths issued receipts with respect to moneys deposited with them.<sup>50</sup> Some receipts were payable to the order of a payee and others to the bearer. Either way, the instrument contained the goldsmiths' undertaking to pay on demand when presented with the receipt. It came to be known as a goldsmiths' or bankers' note and evolved into an early form of the promissory note.<sup>51</sup> Alternatively, rather than taking goldsmiths' notes, a depositor was allowed to draw upon the goldsmith various amounts up to the amount of the deposit. Such drafts, payable on demand and made out to a payee or bearer, were cheques.<sup>52</sup>

Goldsmiths' notes and cheques were payment mechanisms, which facilitated the transmission of funds from a debtor to his creditor. Through the use of such machineries, a depositor/debtor could avoid the need to physically deliver coined money to the creditor. Payment could be made by delivering a goldsmith note or cheque and having the account with the goldsmith debited upon the issue of the note or the presentment of the cheque.<sup>53</sup> Originally, both instruments were interchangeable and indistinguishable,<sup>54</sup> which may explain the original inconsistent terminology used with respect to them.<sup>55</sup> Being dependent for its acceptance 'not upon containing within itself a substance with a value apart from its value as money, but upon people's belief that a promise to exchange it for other money will be honoured',<sup>56</sup> the acceptability of paper depended on the credit of its issuer, irrespective of the form of the instrument.

under s 91(14); ie, 'paper money' was associated with 'banking' but not with 'currency'. Ironically however, until central banking was established in 1934, while banknotes issued by banks circulated in Canada, it was (side by side with coins) paper money issued by the Government (Dominion Notes) which served as legal tender. See text and nn 233–38 below.

<sup>48</sup> A Smith, *The Wealth of Nations* (Chicago: University of Chicago Press, 1976; being the 1776 original text, edited by E Cannan and prefaced by GJ Stigler, 'Two Volumes in One') vol I at 316; Tucker, *ibid* at 161, 164.

<sup>49</sup> Smith, *ibid* at 316–17.

<sup>50</sup> Richards, *Early History*, above n 11 at 40–43.

<sup>51</sup> Holden, above n 13 at 70–73. For the evolution of the form of the goldsmiths' note, see also Feavearyear, above n 33 at 107–08.

<sup>52</sup> For this development, see Holden, *ibid* at 206–10.

<sup>53</sup> Feavearyear, above n 33 at 107–10.

<sup>54</sup> Feavearyear, *ibid* at 258.

<sup>55</sup> Eg, '[w]hen first . . . orders upon goldsmiths came into existence, they were known by various names – "drawn notes" or simply "notes" or "bills". It was not until well into the eighteenth century that the word cheque – or rather "check" . . . came to be applied to this type of instrument'. Holden, above n 13 at 208–09, where he goes on to discuss the subsequent change from 'check' (still used in the US) to 'cheque.'

<sup>56</sup> Feavearyear, above n 33 at 99.

However, over time, each instrument acquired its own niche. Thus, in some respects, cheques were more advantageous than bankers' notes, but their advantage was not absolute. In Holden's words:

[C]heques could be drawn for the exact amount of the debt . . . they provided a permanent record of the settlement; and . . . their use made it unnecessary for customers to keep large amounts of notes and coins on their premises. On the other hand, creditors would prefer to receive bankers' notes rather than cheques from debtors whose financial standing was uncertain.<sup>57</sup>

Consequently, each instrument developed to satisfy different needs. Cheques were more promising payment mechanisms, or devices for the transmission of funds for the purpose of avoiding the need and the risks of carrying money in specie.<sup>58</sup> They were used primarily 'by the nobility and landowning classes, whose signatures were widely known and accepted.'<sup>59</sup> At the same time, inasmuch as the financial standing and the authenticity of the signature were likely to be more certain in the case of a banker than in the case of an unknown depositor, notes issued by bankers were a more promising and widely used medium of exchange.

The banknotes thus became a substitute for money. The ultimate success of the banknote could be attributed not only to the creditworthiness of individual issuers but also to an improvement in the original system of receipt issue by goldsmiths. At the inception of the system, a goldsmith issued one note for the whole sum deposited with him. If any of it was paid off, the amount so paid was marked on the original note.<sup>60</sup> As such the instrument was primarily a deposit-certificate on which the running account and its balance were marked. At the most, the certificate could be transferred as a whole, for the entire amount of the balance at the moment of the transfer. In this framework, it was impossible either to pay with parts of the deposit or to transfer the note to several different creditors. Ultimately, the original system was replaced by a more sophisticated one. The gross deposit was subdivided into several receipts in various denominations; instead of one note containing a single promise to pay the entire sum, the goldsmith gave a series of promises to pay a number of smaller sums making up the total of the deposit.<sup>61</sup> Finally, such notes might be issued by a goldsmith, not against a deposit of coined money or other specie, but rather as proceeds of a loan,<sup>62</sup> albeit, in the normal course of business, as already pointed out,<sup>63</sup> only against the negotiation, and hence discount, of bills of exchange and promissory notes. Goldsmith notes could pass freely from hand to hand in payment of debts between each transferor and transferee.

<sup>57</sup> Holden, above n 13 at 214.

<sup>58</sup> *Ibid* at 213–14.

<sup>59</sup> Feavearyear, above n 33 at 109.

<sup>60</sup> For this practice, see eg *Cooksey v Boverie* (1693) 2 Show. K.B. 296 at 296–97, 89 E.R. 949.

<sup>61</sup> Martin, above n 5 at 127.

<sup>62</sup> For this development, see Holdsworth, above n 4 at 190–91.

<sup>63</sup> See text at n 48 above.

Between the 'Stop of the Exchequer' in 1672 (addressed at the beginning of section 3.2 below) and 1680, 'goldsmiths' notes became unacceptable as general means of payment.<sup>64</sup> However, already towards the end of the seventeenth century, it was judicially acknowledged that '[t]he notes of goldsmiths (whether they be payable to order or to bearer) are always accounted among merchants as ready cash.'<sup>65</sup> At the same time, it was also held that a creditor could refuse a tender of goldsmith's notes and insist on payment in metallic money.<sup>66</sup> Underlying the latter rule was apparently the risk of the goldsmith's default. Indeed, insofar as a goldsmith was authorized to lend money deposited with him,<sup>67</sup> the risk of his failure to meet his obligations to repay deposited money, leading to his insolvency, could not be overlooked, irrespective of his good reputation.<sup>68</sup>

Under some circumstances, a creditor who accepted from his debtor a goldsmith's note in payment of the debt was partly protected against the risk of the goldsmith's insolvency by virtue of the 'conditional payment' principle.<sup>69</sup> In an open defiance to the prevailing mercantile view,<sup>70</sup> this principle, as pronounced by Lord Holt in *Ward v Evans* (1702),<sup>71</sup> was premised on the view that, in the absence of agreement to the contrary, 'paper is no payment where there is a precedent debt', so that 'the acceptance [by a creditor] of . . . a [goldsmith's] note is not actual payment.'<sup>72</sup> Rather, under the conditional payment principle, 'when such a note is given in payment, it is always intended to be taken under this condition, to be [absolute] payment [only] if the money be paid thereon'.<sup>73</sup> That condition was dispensed with upon the creditor's failure to demand payment from the goldsmith 'in convenient time'.<sup>74</sup> Stated otherwise, the 'conditional payment' principle meant that upon the goldsmith's failure, the creditor was entitled to recover from the debtor, provided that timely demand from the goldsmith had been made by the creditor.<sup>75</sup>

<sup>64</sup> JK Horsefield, 'The "Stop of the Exchequer" Re-visited' (1982), 35 *Economic History Review* 511 at 523 (hereafter: Horsefield, 'Exchequer').

<sup>65</sup> *Tassell and Lee v Lewis* (1701) 1 Ld. Raym. 743 at 744, 91 E.R. 1397 at 1398 (K.B.).

<sup>66</sup> *Ibid.*

<sup>67</sup> See text at n 34 above.

<sup>68</sup> Notwithstanding text which follows n 59 above.

<sup>69</sup> See in general, Holden, above n 13 at 85–86, 109–11 (who nevertheless appears to overlook the distinction, set out below, between the situation where the goldsmith note was taken for an antecedent and when it was taken for a present debt).

<sup>70</sup> See *Ward v Evans* (1702) 2 Ld. Raym. 928 at 930, 92 E.R. 120 at 121 (K.B.), where Lord Holt CJ stated the rule 'notwithstanding the noise and cry, that it is the use of Lombard-Street, as if the contrary opinion would blow up Lombard-Street'.

<sup>71</sup> *Ibid.*

<sup>72</sup> *Ibid.*

<sup>73</sup> *Ibid.*

<sup>74</sup> *Ibid.* Compare *Tassell and Lee v Lewis*, above n 65 at 744 (Ld. Raym.) and 1398 (E.R.) where the report cites *Hopkins v Geary* (1702) Hil.1 Ann. B.R. Guildhall. See also *Hill & Al v Lewis* 91 E.R. 124 (1709) 1 Salk. 132, 91 E.R. 124 at 125, (K.B.) where Lord Holt CJ instructed the jury that 'what should be thought convenient time, ought to be according to the usage among traders'.

<sup>75</sup> Note that on the distinction between a precedent and contemporaneous debt, *Ward v Evans* was preceded by *Anon* (1701) Holt. K.B. 298 at 298–99, 90 E.R. 1064. However, in *Anon*, *ibid*, dealing with a seller of goods who took a goldsmith note subsequent to the sale and who delayed presentment until after the goldsmith's presentment, Lord Holt allowed him to sue the buyer on 'the

One problem with the 'conditional payment' principle was that it was stated in *Ward v Evans* to be limited to the taking of a goldsmith note for a *precedent* debt.<sup>76</sup> At the same time, in that case, Lord Holt agreed that a different presumption applies where goldsmith notes are transferred for a present, namely, *contemporaneous* or simultaneously contracted, debt; thus, 'taking a note for goods sold is a payment, because it was part of the original contract.'<sup>77</sup> It thus appears that the distinction drawn between an antecedent debt and present value was rationalized on the intention of the parties; that is, according to Lord Holt it is only when payment is made for a past debt that conditional payment is intended. Presumably, this is so since at the time the debt was incurred, payment in cash was agreed, and the mere taking of an instrument was designed to strengthen the creditor's position and not weaken it; it thus did not amount to a waiver of the right to obtain cash payment, albeit on the instrument. In contrast, according to that logic, a creditor who took a goldsmith note for a present debt indicated his readiness to be satisfied with the goldsmith's liability, and in the absence of specific circumstances to the contrary in a given case, is thus deemed never to have sought the payment obligation of the party who delivered the goldsmith note.

The logic of this distinction is not infallible; in fact, for an obligation of a banker on an instrument, albeit not in itself money, there is nothing to suggest that the distinction between a precedent and contemporaneous debt is still valid.<sup>78</sup> However, having been repeatedly stated by Lord Holt,<sup>79</sup> English cases decided throughout the eighteenth and nineteenth centuries fully adopted his distinction. They thus held that the delivery, against a contemporaneous debt (namely, present value), by a debtor to his creditor, of an instrument on which a third party, not necessarily a banker, was liable, was presumed to be in full discharge. Stated otherwise, on its own, the transaction was a sale of the instrument for the contemporaneous debt, without a warranty or any other undertaking by the instrument 'seller' as to payment by the third party liable on the instrument.

Effectively then, case law distinguished the delivery of a banknote for a contemporaneous debt (that is, present value) from delivery of a banknote for a

debt upon the original contract' but not the 'bill'. It is noteworthy that he used 'note' and 'bill' interchangeably as well as referring to the maker of the banknote as the drawee who was instructed to pay by his customer the buyer of the goods.

<sup>76</sup> Above n 70.

<sup>77</sup> *Ibid.*

<sup>78</sup> AG Guest, *Chalmers and Guest on Bills of Exchange, Cheques and Promissory Notes*, 17th edn (London: Sweet & Maxwell, Thomson Reuters 2009) at 490. Cf section 3-310(a) of the *American Uniform Commercial Code* (U.C.C. §3-310(a) (1990) (as amended 2002)) which equally, does not distinguish between a precedent and contemporaneous debt, and yet reverses the conditional payment principle in the case of an instrument on which a bank is liable, providing that the taking of such an instrument is presumed to constitute absolute payment (with no recourse to the party who gave it).

<sup>79</sup> See eg *Clerk v Mundall* (1700) 12 Mod. 203, 88 E.R. 1263; and *Bank of England v Newman* (1700), 12 Mod. 241, 88 E.R. 1290. Cf *Anon* (1701), above n 75.

precedent (that is, antecedent or past) debt; only the latter was presumed to be 'conditional payment'. For example, in *Camidge v Allenby* (1827)<sup>80</sup> a buyer of corn paid to the seller subsequent to the sale. In line with earlier precedents,<sup>81</sup> Bayley J stated the guiding principle to be, other than in the case of fraud, that '[i]f the notes had been given to the plaintiff at the time when the corn was sold, he could have no remedy upon them against the defendant. The plaintiff might have insisted upon payment in money. But if he consented to receive the notes as money, they would have been taken by him at his peril.'<sup>82</sup>

At the same time, throughout the nineteenth century, the 'conditional payment' principle did not fare well in the United States, where it did not carve out a well defined territory for itself.<sup>83</sup> Some cases adhered to it.<sup>84</sup> However, it appears that not everybody was convinced by the logic of Lord Holt's distinction. As well, it is possible to speculate that the absence of any substitute in the form of central banknotes may have led some to aspire for a finality rule also for payment in paper. Be that as it may, some cases disregarded Lord Holt's distinction altogether, and opted for a final and absolute, namely unconditional, payment presumption. Among them, some held that this payment-finality presumption always applied.<sup>85</sup> Others excepted from it banknotes of a bank that had failed by the time its banknotes were taken by the creditor.<sup>86</sup> In such a case of a failed bank, and only in such a case, the 'conditional payment' principle was said to apply. For courts that did not adhere to Lord Holt's distinction, all of this was regardless of whether the note was taken for a precedent or a contemporaneous debt.<sup>87</sup> In the absence of a 'conditional payment' principle, creditors taking banknotes had to rely exclusively on the creditworthiness of the banker liable on the instrument. At present, the 'absolute payment' presumption, ultimately accorded by the American *Uniform Commercial Code* to instruments on which a bank is liable,<sup>88</sup> is associated with payment instruments such as cashier's cheques, teller's cheques and money orders, and not banknotes.

Certainly, where applied, the 'conditional payment' principle accorded protection to a creditor receiving goldsmith notes. Nevertheless, even then protection was not full. To begin with, the contingency of a possible action against the debtor after payment in goldsmith's notes had rendered such notes less

<sup>80</sup> 6 B. & C. 373, 108 E.R. 489.

<sup>81</sup> See eg, *Emly v Lye* (1812) 15 East. 7 at 13, 104 E.R. 746. See also *Fenn v Harrison* (1790) 3 T.R. 757 at 759–60, 100 E.R. 842 at 844; and *Ex parte Blackburne* (1804) 10 Ves. Jun. 204, 32 E.R. 823.

<sup>82</sup> Above n 80 at 381–82 (B. & C.), 492 (E.R.). In that case the plaintiff-seller nevertheless failed for neglecting to timely advise the defendant-buyer of the bankers' insolvency. *Ibid* at 382–83 (B. & C.), 493 (E.R.).

<sup>83</sup> For an exhaustive summary, against the background of the English precedents, on which the ensuing discussion draws, see JS Rogers, 'The New Old Law of Electronic Money' (2005), 58 *Southern Methodist University Law Review* 1253 at 1287–97.

<sup>84</sup> See eg *Corbit v Bank of Smyrna* 2 Harr. 235 (Del. 1837).

<sup>85</sup> See eg *Scruggs v Gass* 16 Tenn. 175 (1835); and *Lowrey v Murrell* 2 Port. 280 (Ala., 1835).

<sup>86</sup> The leading case is *Ontario Bank v Lightbody* 13 Wend. 101 (N.Y., 1834).

<sup>87</sup> In the US, the issue only became more complicated as the line between precedent and contemporaneous debts became blurred. See eg *Hall v Stevens* 22 N.E. 374 (NY Supp. Ct., 1889).

<sup>88</sup> See n 78 above. For the instruments listed in the text above, see U.C.C. §3-104.

attractive to creditors than coined money. Only payment by coins led to a final and immediate discharge of the debt. Second, a debtor who had deposited his money with a goldsmith who later became insolvent might have lost a substantial sum of money upon his goldsmith's failure, so that, generally speaking, he was not a promising defendant in terms of his creditworthiness. Third, the creditor's remedy against the debtor might be lost where the creditor failed to make a timely demand for payment upon the goldsmith. Faced with the risk of a goldsmith's failure and not being adequately protected against it, a creditor could not be required to accept goldsmith notes as complete substitutes for coined money. It is for this reason that, notwithstanding the 'conditional payment' principle, goldsmith notes have not been made legal tender, a quality that ultimately was bestowed on Bank of England notes, as discussed in section 3.2 below.

Indeed, as pointed out in chapter one, section 3.3 above, 'legal tender' is money that, at least in the absence of an agreement to the contrary, a debtor may offer and the creditor must accept in discharge of a debt. In turn, as was already recognized in chapter one, section 2 above, a leading English case defined 'money' to be 'that which passes freely from hand to hand throughout the community *in final discharge of debts* . . . being accepted equally without reference to the character or credit of the person who offers it and without the intention of the person who receives it to consume it' (emphasis added).<sup>88.1</sup> Strictly speaking, this definition excludes goldsmith notes that passed in conditional and not final payment of debts. There is however no question that goldsmith notes, and their successors, private banknotes, circulated and were accepted in payment of debts, so as to have strong distinctive monetary features. As discussed further below in section 3.2 of this chapter, lacking the attribute of final discharge, they were ultimately replaced by central banknotes.

Thus, the recognition of the banker's note as a complete substitute for high-value coins, that is, as money which is legal tender, came only following the establishment of the Bank of England and its note issue. The process leading to the predominance and unqualified victory of the banknote as a specie of money was thus accomplished only when the risk of a banker's insolvency was eliminated. At the same time, while certainly invigorated by the support provided by the Bank of England, once it was established, the goldsmith system proved itself, even on its own, to be strong enough to allow for the foundations, growth and development of the cheque as a payment mechanism in the context of a comprehensive national interbank system.

## 2.3 Goldsmith Banking System: The Network

While the goldsmith's note is the forerunner of the banknote as paper money, the goldsmith cheque system developed to lay the foundations of the national

<sup>88.1</sup> *Moss v Hancock* [1899] 2 Q.B. 111 at 116.

cheque system as we know it today. Indeed, while the Bank of England replaced the goldsmith as a note issuer, it did not replace the goldsmith as a cheque drawee. Rather, by providing, in due course, an enhanced settlement facility, it only improved, and did not supersede altogether, the goldsmith cheque system. Other than that, except for the ongoing introduction over the years of technological improvements, the fundamentals of the modern cheque system can directly be traced to the seventeenth-century interbank goldsmith cheque system. For its part, the cheque system served also as a model for subsequent systems for the clearing and settlement of payment orders other than those on a cheque.

During the second half of the seventeenth century, through a tight network of correspondent banking facilitating a systematic debt clearing, goldsmith banking allowed interbank customer payments to take place on a regular basis.<sup>89</sup> It was this tight network which underlay the emergence of a national banking system facilitating both a national payment system premised on the cheque as well as the indispensable role of banks as financial intermediaries. Arguably, it is the efficiency attributed to that network which enabled the goldsmiths to supersede altogether the scriveners, on whose services as depositaries the goldsmiths themselves counted in the early days of their monetary operations.<sup>90</sup>

Richards<sup>91</sup> identifies *Vyner v Clipsham*,<sup>92</sup> as '[p]robably the first case involving the use of cheques.'<sup>93</sup> According to his account, the case demonstrates the existence, albeit not the operation, of an interbank goldsmith system. It was concerned with a transfer from an account of a customer with one goldsmith to an account of the same customer with another goldsmith. The transfer was carried out by means of a cheque drawn on one goldsmith and deposited into the account with the other. The latter paid the depositor twice and was seeking to recover the second payment.

The goldsmith network manifested itself primarily in the effective clearing of interbank payments embodied in banknotes and cheques. The goldsmith clearing system was strictly bilateral. 'Moreover, the goldsmith-bankers avoided depositing large sums with each other by routinely creating overdrafts.'<sup>94</sup> Stated otherwise, a goldsmith did not demand from a fellow-goldsmith a positive balance as a precondition for paying an instrument presented to him by the fellow-goldsmith. Rather, payment was immediately made by the 'cashing' goldsmith upon the delivery of the cheque to him in reliance on credit extended by him to

<sup>89</sup> See in detail, S Quinn, 'Balances and Goldsmith-bankers: The Co-ordination and Control of Inter-banker Debt Clearing in Seventeenth-century London' in D Mitchell (ed), *Goldsmiths, Silversmiths and Bankers: Innovation and the Transfer of Skill, 1550 to 1750* (London: Alan Sutton Publishing and Centre for Metropolitan History, 1995) at 53.

<sup>90</sup> For the use of the scriveners by the goldsmith in the early days of the latter monetary operations, see eg Feavearyear, above n 33 at 102.

<sup>91</sup> Richards, *Early History*, above n 11 at 49–50.

<sup>92</sup> Richards, *ibid* cites it as PRO, Ch P., before 1714 (Reynardson), 35/66. I was unable to verify this source.

<sup>93</sup> Holden, above n 13 at 209.

<sup>94</sup> Quinn, above n 89 at 54.



the fellow-goldsmith on which the cheque was drawn.<sup>95</sup> This did not unnecessarily tie up funds, and it facilitated expansion.<sup>96</sup>

Instruments were accepted and cleared at par. There was no formal institutional structure to the clearing system which was based on trust and credit monitoring. Accordingly, there were no fixed times for each bilateral clearing, with the frequency of settlement determined according to individual assessment of the creditworthiness of the liable counterparty. Usually, the net difference between two bilateral gross claims was settled every few days, and in specie, namely coined money. In such a system, being based on credit assessment and trust, '[t]he implicit cost of credit risk was being traded off against the more explicit costs of holding and transporting the settlement asset.'<sup>97</sup>

Inasmuch as the clearing system was premised on ongoing relationships among the goldsmiths, it improved on the Medieval exchange clearing in two ways. First, the goldsmith network, albeit of 'artisan' origin, turned out to be exclusively a banking network and not one superadded to a mercantile one. Second, the goldsmith network was based on continuity and on daily practice, involving the routine extension of credit from one goldsmith to another, rather than being limited to periodic events.<sup>98</sup> In turn, fellow-goldsmiths credit monitoring, which characterized the operation of the network, appears to have led the way to customer credit monitoring, and hence, to specialization in information-intensive non-traded loans as bank assets. Ultimately, here lie the roots of the financial intermediation, between depositors and borrowers, performed by banks.

For its part, the initial trust, without which the system could not have operated, may be explained by the goldsmith trade's earlier specialization in precious metals and the lengthy intensive apprenticeship required for the purpose of becoming a goldsmith, which was fully adapted to train the goldsmith to become a banker. 'In exchange of seven years of non-wage skilled labour and often an initial fee, the master taught the apprentice the necessary banking skills, introduced him to established bankers and developed the ground work for a long professional relationship.'<sup>99</sup> In the final analysis, in laying down the foundations for the modern banking system on the basis of concepts and institutions that had already evolved elsewhere, London bankers took advantage of their goldsmith background and put it into use.

<sup>95</sup> This improved on the Amsterdam Exchange Bank system under which a bill presented for payment was paid on the following day and only against an offsetting bill in the opposite direction. See Quinn, *ibid* at 55 and Richards, *Early History*, above n 11 at 234–35.

<sup>96</sup> At the same time, in this mutual dependence lies the roots of the 'systemic risk', being presently defined as 'the risk that the inability of one of the participants to meet its obligations . . . could result in the inability of other system participants . . . to meet their obligations as they become due.' Committee on Payment and Settlement Systems (CPSS), *Core Principles for Systemically Important Payment Systems* (Basle: Bank for International Settlements, January 2001) at 5 (hereafter: *Core Principles*).

<sup>97</sup> Manning, Nier and Schanz, above n 22 at 26.

<sup>98</sup> The Medieval 'payment fair' exchange clearing is set out above in ch 8, section 3 text and nn 150–58.

<sup>99</sup> Quinn, above n 89 at 61.

Goldsmith banking is thus the source of banking combining and improving on the banknote, cheque, and bill discounting. Indeed, each such institution or concept can be traced to an earlier development. Thus, cheques go back to Greco-Roman Egypt (and later to Medieval Italy); banknotes go back to Continental public banks; paper money goes back to China at the beginning of the second millennium CE; deposit banking goes back to Ancient Greece, as well as later, to Medieval Italy; bills of exchange and their endorsement go back to Medieval Continental Europe. At the same time, goldsmiths clearly deserve the credit for combining these techniques institutionally, for the continuity of the use of these instruments, and for the development of their underlying concepts, leading to modern banking.<sup>100</sup>

### 3. BANK OF ENGLAND: NOTE ISSUE, CHEQUE SETTLEMENT AND CENTRAL BANKING

#### 3.1 Introduction

According to Morgan:

The functions of a modern central bank are fourfold: to act as a manager of the National Debt and banker to the government; to regulate the currency; to be a banker's bank; and to act as a lender of last resort.<sup>101</sup>

Morgan made this statement in the middle of the twentieth century; nonetheless, in essence, it still holds true today, albeit subject to four clarifications. First, as the regulator of the currency, the central bank is typically both its issuer and the one that implements, if not also formulates, the monetary policy designed to keep its value of the currency in the form of domestic price stability. Second, as the banker's bank, the central bank maintains settlement or reserve accounts, at least for major banks. Typically, the ultimate settlement of obligations incurred in the payment system takes place over those accounts. Third, in discharging its stated functions, the central bank has become positioned to provide important oversight and even regulatory roles with respect to the payment system, and in fact, to the entire financial system, particularly with respect to its

<sup>100</sup> It is in this context that I agree with Rogers, *Bills and Notes*, above n 29 at 116 that 'the appearance of banks [in post-Medieval England] was less a matter of creation of new financial techniques than an institutional rearrangement in which certain firms came to specialize in financial dealings which had long been performed as adjuncts to mercantile or other activities.' However, prior to their introduction and use by goldsmiths, not all of these techniques had been known in England.

<sup>101</sup> EV Morgan, *The Theory and Practice of Central Banking 1797–1913* (New York: AM Kelly, 1965, reprint of 1943 edition) at 1. The central bank's 'functions' are not the same as the central bank's 'objectives'. For the latter see eg: F Gianviti, 'The Objectives of Central Banks' in M Giovanoli and D Devos (eds), *International Monetary and Financial Law: The Global Crisis* (Oxford, Oxford University Press, 2010) at 449.

stability.<sup>101.1</sup> Fourth, additional tasks may relate to management of debt and foreign exchange reserves as well as exchange controls.<sup>102</sup>

Morgan goes on to state that '[e]ven at the beginning of the nineteenth century we can find [in the Bank of England] important traces of all [four] functions.'<sup>103</sup> At the same time, it is obvious that the beginning was less promising. During the eighteenth century, the Bank of England 'was not a central bank in the modern sense.'<sup>104</sup> In fact, the Bank of England was established in 1694, in the modest and unpretentious form of the mere incorporation by statute of a group of subscribers to a loan extended to the Whig government of the day.<sup>105</sup> According to Holden, the creation of the Bank 'was really the work of an impecunious government striving to borrow money in order to wage war against France.'<sup>106</sup> Indeed, proposals inspired by Continental public banks, particularly after the establishment of the Exchange Bank of Amsterdam, floated in London since the end of the sixteenth century.<sup>107</sup> However, events such as the 'forcible loan' by King Charles I in 1640 and the 'Stop of the Exchequer' by King Charles II in 1672,<sup>108</sup> eroded public support in entrusting banking to royal public authorities; the King was suspect of being capable of 'manufacturing' a capricious default to his sole benefit and to the detriment of his subjects. In turn, the King feared the accumulation of power in the hands of the moneyed class which would run, and benefit from, the public bank.<sup>109</sup>

<sup>101.1</sup> The emergence of councils for financial stability under the purview of the central bank to undertake systemic risk control or macro-prudential supervision is a feature of very recent legislative reform projects in the UK, USA, and the EU. RM Lastra, 'Systemic Risk SIFIs, and Financial Stability' (2011), 6 *Capital Markets Law Review* 197, 198.

<sup>102</sup> See in general, RM Lastra, *Central Banking and Banking Regulation* (London: Financial Markets Group, 1996) at 249–86 (Appendix: 'Evolution of the Functions of a Central Bank. The Rationale of Central Banking').

<sup>103</sup> Morgan, above n 101.

<sup>104</sup> See HV Bowen, 'The Bank of England During the Long Eighteenth Century, 1694–1820' in D Roberts and D Kynaston (eds), *The Bank of England: Money, Power, and Influence 1694–1994* (Oxford: Clarendon Press, 1995) at 1. See also A Cairncross, 'The Bank of England and the British Economy' in *ibid* at 56.

<sup>105</sup> *The Ways and Means Act, 1694* (UK), 5 & 6 Will. & Mar., c. 20, s. XIX. See Holden, above n 13 at 88. The foundation of the Bank of England and its early transactions are extensively discussed by Richards, *Early History*, above n 11 at 132–88; as well as RD Richards, 'The First Fifty Years of the Bank of England (1694–1744)' in G Van Dillen (ed), *History of the Principal Public Banks* (London: Frank Cass, 1964, being 2nd impression of the 1934 1st edn, The Hague: Martinus Nijhoff, 1934) at 201 (hereafter: Richards, 'First Fifty Years'). See also Davies, above n 17 at 255–63.

<sup>106</sup> Holden, *ibid* at 87–88. This conclusion is in line with the assessment by Egleton and Williams, above n 19 at 185. For an earlier assessment to the same effect, see W Bagehot, *Lombard Street: A Description of the Money Market* (New York: Charles Scribner's Sons, 1895) at 92–94. For the Bank and its financing of the operation of the Whig Government, see in general, Holdsworth, above n 4, at 188–89. This was the Nine Years' War (1688–97), also known as the War of the Grand Alliance, the War of the League of Augsburg, formerly the War of the Palatine Succession or the War of the English Succession, and also the Williamite War (Ireland) and King William's War (North America), for which you can visit [www.en.wikipedia.org/wiki/Nine\\_Years%27\\_War](http://www.en.wikipedia.org/wiki/Nine_Years%27_War).

<sup>107</sup> For a brief review, see eg Holdsworth, *ibid* at 182–83.

<sup>108</sup> For these events see, respectively, n 30 above, and text around n 120 below.

<sup>109</sup> Holdsworth, above n 4 at 186–87.

No wonder public banking goes back to republic city-states, where the rulers came from moneyed citizens.<sup>110</sup> 'With their republican institutions, the [Dutch] United Provinces combined the advantages of the city-state with the scale of a nation-state';<sup>111</sup> at the same time, the institution may not have been transplantable in a 'monarchist' environment, unless the King's power was significantly curtailed. Indeed, it is only in the aftermath of the Glorious Revolution in 1688, under which power in England shifted to a parliamentary government,<sup>112</sup> that the interests of government and those governed converged, so as to facilitate the establishment of the Bank of England to the benefit of both government and subjects.<sup>113</sup>

Thus, at the end of the seventeenth century, in return for a loan of £1.2 million, perhaps £5 billion in today's money, the promoters 'received the privilege of forming the first and for well over a century the only joint-stock bank in England and Wales, which meant it had a much larger capital than any other bank.' The new institution became a banker to the Government, and early in the eighteenth century 'it was appointed "principal agent" for the issue and circulation' of short-term government securities; further, it made major contributions to war finance, as well as to the establishment of money and capital markets.<sup>114</sup>

Stated otherwise, the Bank of England started as a commercial bank, accorded with a strong competitive advantage, in the form of size, incorporation, good connections, and a major client, viz, the Government. Being backed by the Government, as well as being in the interest of the merchant community of 'Lombard Street', it commenced to serve the public good by gradually assuming functions and roles that in hindsight we identify with central banking.<sup>115</sup>

It is said that 'payment systems are the foundation on which central banks' core functions are built.'<sup>116</sup> Consistent with this view, the evolution of functions relat-

<sup>110</sup> Venice, whose public bank, established towards the end of the sixteenth century, provided the model for those that followed (as discussed in ch 8, text around nn 60–61) fits this description. According to FC Lane, *Venice A Maritime Republic* (Baltimore: John Hopkins University Press, 1973) at 103, in Venice, 'an upper class of nobles or magnates' shared power with 'a middle class of shopkeepers and artisans' and 'merchants and landowners with economic interests very similar to those of the nobles and magnates.'

<sup>111</sup> Ferguson, above n 43 at 74.

<sup>112</sup> The Glorious Revolution, also called the Revolution of 1688, was the overthrow of King James II of England in 1688 by a union of Parliamentarians with an invading army led by the Dutch *stadtholder* William III of Orange-Nassau (William of Orange) who, as a result, ascended to the English throne as William III of England. Visit: [www.en.wikipedia.org/wiki/Glorious\\_Revolution](http://www.en.wikipedia.org/wiki/Glorious_Revolution).

<sup>113</sup> A point highlighted by Ferguson, above n 43 at 75.

<sup>114</sup> R Roberts, 'The Bank of England and the City' in Roberts and Kynaston, above n 104 at 152, 153. For its origins see also T Rogers, *The First Nine Years of the Bank of England* (Oxford, Clarendon Press, 1887).

<sup>115</sup> The debate as to whether overall the establishment of central banking had been politically forced (and hence arguably of negative impact) or a natural economic development (and hence arguably of positive impact) is outside the scope of the present discussion. For this debate see eg C Goodhart, *The Evolution of Central Banks* (Cambridge Mass: The MIT Press, 1988); VC Smith, *The Rationale of Central Banking and the Free Banking Alternative* (Indianapolis: Liberty Press, 1990, reprint of 1936 original); and MD Bordo and A Redish, 'Why Did the Bank of Canada Emerge in 1935?' (1987), 47:2 *Journal of Economic History* 405.

<sup>116</sup> AG Haldane and E Latter, 'The Role of Central Banks in Payment Systems Oversight' (2005), 45 *Bank of England Quarterly Bulletin* 66 at 67.

ing to the payment system is elaborated below in conjunction with the emergence of central banking as a whole. Emphasis is given to the evolution of payment system services, operations, and instruments leading to the formation of central banking infrastructure.<sup>117</sup> Particularly, the way in which payment system functions developed to facilitate other central banking tasks will be demonstrated. It will also be demonstrated how the development of other central banking tasks facilitated the enhancement of services and responsibilities in the payment area.<sup>118</sup>

### 3.2 Bank of England Notes

Goldsmith notes were not the only circulating paper media in seventeenth-century England. Rather, interest-bearing Exchequer orders, reflecting claims to government revenue, some of which were even endorsable, circulated as well. Such instruments were liquid and therefore held by goldsmiths. However, with the mounting of public debt, and the refusal of the then overstretched goldsmiths to lend to him, King Charles II issued a Proclamation on 2 January 1672 generally prohibiting payment from the Exchequer. This ‘Stop of the Exchequer’, which was ultimately extended indefinitely, had a ruinous effect on goldsmiths for whom vast assets held by them became illiquid.<sup>119</sup> It is further said to have delayed the establishment of the Bank of England,<sup>120</sup> and of course it resulted in a ‘shock to royal credit. Had it not been for the Stop, Britain might have had a permanent issue of state notes.’<sup>121</sup>

In the absence of such state notes, and probably having in mind the Swedish experiment, and perhaps others, such as the 1690 note issue by the Government of the Massachusetts Bay Colony in North America,<sup>122</sup> some of the designers of the Bank of England wanted notes issued by it to circulate as money.<sup>123</sup> However, neither the Act of Parliament nor the Charter conferred upon the Bank an explicit note issuing power.<sup>124</sup> Nonetheless, the Bank of England modelled its banking

<sup>117</sup> The resulting role in payment system oversight is thus outside the scope of the present discussion. For this increased role particularly see *Core Principles*, above n 96 at 11–12 and, in greater detail, Committee on Payment and Settlement Systems (CPSS), *Central Bank Oversight of Payment and Settlement Systems* (Basle: Bank for International Settlements, May 2005).

<sup>118</sup> See B Norman, R Shaw and G Speight, *The history of interbank settlement arrangements: exploring central banks’ role in the payment system* (Bank of England Working Paper No 412, June 2011). Central banks and payment systems is by far the main theme of essays published in AG Haldane, S Millard and V Saporta (eds), *The Future of Payment Systems* (London: Routledge, 2008).

<sup>119</sup> Horsefield, Exchequer, above n 64 setting out at 523–28 the impact on individual goldsmith-bankers.

<sup>120</sup> Davies, above n 17 at 252–55.

<sup>121</sup> *Ibid* at 254. By way of comparison, as discussed further below at text and nn 233–38, in Canada, prior to the establishment of a central banking system in 1934, (side by side with bank-notes intended for circulation and issued by the chartered banks) Dominion Notes, backed by gold and redeemable in specie, issued by the Government of Canada served as paper money.

<sup>122</sup> For both of these experiments see Eagleton and Williams, above n 19 at 179, 183. The Swedish experiment is alluded in ch 8 in text and n 86 above.

<sup>123</sup> Holden, above n 13 at 88.

<sup>124</sup> *The Ways and Means Act*, above n 105, provided in s XXIX for the Bank’s power to issue formal notes under seal. ‘These notes were used for making payments to the Exchequer from the Bank. The

operations on those of the goldsmiths,<sup>125</sup> and shortly after its establishment, began to issue to depositors, 'probably to a very considerable extent',<sup>126</sup> notes payable to bearer, similar to those of the goldsmith.<sup>127</sup> Their recognition as a universal medium of exchange came from Lord Mansfield in 1758 in *Miller v Race*:

Now they are not goods, not securities, nor documents for debts, nor are so esteemed: but are treated as money, as cash, in the ordinary course and transaction of business, by the general consent of mankind; which gives them the credit and currency of money, to all intents and purposes. They are as much money, as guineas themselves are; or any other current coin, that is used in common payments, as money or cash.<sup>128</sup>

Once introduced, the Bank of England notes competed successfully with goldsmith notes and finally superseded them as paper money.<sup>129</sup> The risk attached to the goldsmith note of the goldsmith's insolvency, while depending on relative creditworthiness of the particular issuer and, as such, generally smaller than the risk attached to the cheque,<sup>130</sup> was nevertheless greater than the risk attached to the Bank of England note. 'That the new institution did provide circulating notes and did not become bankrupt is a matter of history.'<sup>131</sup> Ironically, the continued solvency of the Bank of England had been supported by the goldsmiths themselves. Some of them were included among the subscribers of the original loan that established the Bank,<sup>132</sup> and many goldsmiths 'opened accounts with the Bank within a few months of its creation' and therefore did not wish 'to see it financially embarrassed.'<sup>133</sup>

Indeed, the quality of legal tender, viz, 'money that is legally valid for the payment of debts and that must be accepted for that purpose when offered'<sup>134</sup>

Exchequer then paid them out to the government's creditors, but they never seem to have become a popular form of currency.' Holden, *ibid* at 89. The silence of the statute as to the Bank's power to issue circulating notes is explained by Feavearyear by the strong opposition to that power, and the promoters' scheme to defuse this opposition by avoiding attention to their intention as to make the Bank a bank of circulation and issue, and not merely a bank of deposit. Feavearyear, above n 33 at 126.

<sup>125</sup> Holdsworth, above n 4 at 188.

<sup>126</sup> *Bank of England v Anderson* (1837) 3 Bing. (N.C.) 589 at 654, 132 E.R. 538 at 562, per Tindal CJ (C.P.).

<sup>127</sup> Holden, above n 13 at 89–90. Originally, such notes were of two types. Notes of the first type contained a promise to pay the whole of a deposit, or some irregular sum. Notes of the second type contained a promise to pay a round sum. 'The note for a round sum soon became popular and gradually ousted that for an irregular amount.' *Ibid* at 89. See in general Richards, *Early History*, above n 11 at 153.

<sup>128</sup> (1758) 1 Burr. 452 at 457, 97 E.R. 398 at 401 (K.B.).

<sup>129</sup> Holden, above n 13 at 92.

<sup>130</sup> See above, text that follows n 59.

<sup>131</sup> Holden, above n 13 at 92.

<sup>132</sup> Richards, 'First Fifty Years', above n 105 at 257.

<sup>133</sup> Holden, above n 13 at 93.

<sup>134</sup> Definition of 'legal tender' at [www.merriam-webster.com/dictionary/legal tender](http://www.merriam-webster.com/dictionary/legal%20tender) (which in my view is superior to that of BA Garner (ed in chief), *Black's Law Dictionary*, 9th edn (St Paul MN: West, 2009) at 979, under which it is '[t]he money (bills and coins) approved in a country for the payment of debts, the purchase of goods, and other exchanges for value'). Both definitions are incomplete in failing to recognize the power of parties to contract out of the duty to accept legal tender in payment of debts and choose other currencies or modes of payment instead. See also ch 1, text and n 68 above.

could only be conferred upon paper issued by a creditworthy banker.<sup>135</sup> Thus, after some judicial hesitation,<sup>136</sup> notes of the Bank of England were made legal tender by statute, the relevant provision being section 6 of the *Bank of England Act, 1833*.<sup>137</sup> Today, Bank of England notes remain legal tender under the *Currency and Bank Notes Act, 1954*.<sup>138</sup>

Issued by a state bank, a most creditworthy promissor, and being legal tender, Bank of England notes were not subject to the 'conditional payment' principle. As discussed, the latter governed goldsmith notes – at least when taken in discharge of antecedent debts.<sup>139</sup> Rather, payment in Bank of England notes was held to be as good as 'payment . . . in gold'<sup>140</sup> so as to provide the giver with the comfort of an absolute discharge, as well as to furnish the taker with a default-free instrument.

Goldsmith notes were never accorded a legal tender status, but their ultimate demise was nonetheless gradual. Thus, an Act of 1708<sup>141</sup> forfeited the private note-issuing power of banking firms. The London goldsmith note-issue 'totally ceased in 1750; since which, the Bank of England has been the sole bank of issue in the metropolis.'<sup>142</sup> However, in 1826 the note-issue power was restored to non-London banks, provided they did not conduct business within 65 miles of London, and that every member of an issuing banking firm was to be fully liable for debts under the demand notes.<sup>143</sup> This note issuing power was severely curtailed and subsequently disappeared following the passage of the *Bank Charter Act, 1844*.<sup>144</sup>

The framers of the *Bank Charter Act, 1844* intended that the exclusive responsibility for issuing banknotes should eventually reside in the hands of the

<sup>135</sup> For the features of the typical banknote as presently issued, see section 4 below.

<sup>136</sup> In *Wright v Reed* (1790) 3 T.R. 554, 100 E.R. 729 (K.B.), Ashurt J thought that notes issued by the Bank of England 'are money to *all* intents' (emphasis added). But Lord Kenyon ChJ understood *Miller v Race*, above n 128 (and see quote which follows) to hold that these notes 'are considered as money to many purposes.' Buller J inclined to support Ashurt J, but ultimately sided with the Chief Justice. Acknowledging that 'banknotes pass in the world as cash', he nonetheless stressed that '[t]his Court has never yet determined that a tender of banknotes is at all events a good tender.' In *Ex parte Imeson* (1815) 2 Rose's Bkcy Cas. 225, instruments payable in 'Bank of England Notes' were held not to be payable in 'money' within the meaning of a statute governing promissory notes.

<sup>137</sup> (UK), 3 & 4 Will. IV, c. 98. More accurately, the statute made the Bank's notes legal tender in England and Wales for all payments (except for by the Bank itself) over £5. See Holden, above n 13 at 196.

<sup>138</sup> (UK), 2 & 3 Eliz. II, c. 12.

<sup>139</sup> For this principle as applied to goldsmith's notes, see text at nn 41–42 up to the end of the paragraph that follows, above.

<sup>140</sup> *Currie v Misa* (1875) 10 L.R. Exch. 153 at 164. See also *The Guardians of the Poor of the Lichfield Union v Greene* (1857) 26 L.J.R. (N.S.) Exch. 140 at 142.

<sup>141</sup> 7 Ann. c. 30 s 66. See in general, Holden, above n 13 at 93–94, 213 (where the statute is however misidentified as 7 An., c. 7, s 61). The prohibitions applied to bodies 'exceeding the Number of Six Persons in that Part of Great Britain called England to borrow owe or take up any Sum or Sums of Money on their Bills or Notes payable at Demand or at any less Time than Six Months from the borrowing thereof.'

<sup>142</sup> Lawson, above n 28 at 213.

<sup>143</sup> *Country Bankers Act, 1826* (UK), 7 Geo. IV, c. 46. See in general, Holden, above n 13 at 195–96.

<sup>144</sup> (UK), 7 & 8 Vict., c. 32.



Bank of England.<sup>145</sup> To that end they specifically designated an issue department in the Bank, endowed with securities and gold, to back the banknote issue. The statute provided that the note-issuing power was not to be conferred upon any new bank. Furthermore, in order to retain their issuing power, existing banks had to meet certain conditions relating to their solvency, their continuance of note-issuing, and their corporate structure.<sup>146</sup> Private note-issuing was thus gradually phased out. During the second half of the nineteenth century, the volume of notes issued by banks other than the Bank of England progressively declined.<sup>147</sup> This development might have been what prompted an English court in 1861 to say, though in the context of Hungarian money, that '[t]he right of issuing notes for payment of money, as part of the circulating medium' belonged to 'the supreme power in every State.'<sup>148</sup> This became true in England in 1921<sup>149</sup> when Messrs Fox, Fowler & Co, the last surviving note-issuing banking firm, merged with Lloyds Bank Ltd and thereby lost its power to issue notes. Exclusive authority for issuing banknotes was thenceforth in the hands of the Bank of England.<sup>150</sup>

When World War I broke out in 1914, the monopoly of the Bank of England in issuing paper money was temporarily challenged by the *Currency and Bank Notes Act, 1914*. This statute authorized the issue of currency notes by the Treasury to provide emergency currency.<sup>151</sup> Such notes, as well as postal orders, were made legal tender.<sup>152</sup> These legislative provisions were repealed in 1928.<sup>153</sup> The repealing statute provided for the amalgamation of the Treasury note issue into the note issue of the Bank of England<sup>154</sup> and further enhanced the status of

<sup>145</sup> Holden, above n 13 at 278.

<sup>146</sup> *Ibid* at 197–98.

<sup>147</sup> *Ibid* at 277–78.

<sup>148</sup> *Emperor of Austria v Day and Kossuth* (1861) 3 De G.F. & J. 217 at 234, 45 E.R. 861 at 868 (Ch. App.), per Lord Campbell.

<sup>149</sup> But banks in Scotland and Northern Ireland may still issue notes lawfully. Such banknotes may circulate also in England. See Holden, above n 13 at 278, fn 3. Non-circulating £1 million and £100 million banknotes issued by the Bank of England, called Giants and Titans, back the issues of Scottish and Northern Irish issuing banks. See [www.bankofenglandjobs.co.uk/our-people/chas/](http://www.bankofenglandjobs.co.uk/our-people/chas/). In Scotland, the issue of banknotes is regulated by the *Bank Notes (Scotland) Act, 1845* (UK), 8 & 9 Vict., c. 38. Under its s 5, '[a]ll bank notes to be issued or re-issued in Scotland shall be expressed to be for payment of a sum in pounds sterling, without any fractional parts of a pound'. Scottish banknotes are not legal tender even in Scotland and are convertible to pound sterling. But cf HC Bill 16, *Scottish Banknotes (Acceptability in United Kingdom) Bill*, 2008–2009 Sess., 2009 (1st reading 21 January 2009), [www.publications.parliament.uk/pa/cm200809/cmbills/016/09016.1-i.html](http://www.publications.parliament.uk/pa/cm200809/cmbills/016/09016.1-i.html), under whose s 1, other than when forgery is suspected, 'a business must not make any distinction between Scottish and other banknotes issued in the United Kingdom in terms of acceptability as payment for goods and services.' For HM Treasury Consultation Document, 'Banknote issue arrangements in Scotland and Northern Ireland' (July 2005), visit [www.webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/consultations\\_and\\_legislation/banknote\\_issue\\_arrangements/banknote\\_issue\\_arrangements\\_index.cfm](http://www.webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/consultations_and_legislation/banknote_issue_arrangements/banknote_issue_arrangements_index.cfm).

<sup>150</sup> Holden, *ibid* at 278; RM Goode, *Payment Obligations in Commercial and Financial Transactions* (London: Sweet & Maxwell, 1983) at 2.

<sup>151</sup> (UK) 4 & 5 Geo. V, c.14, s 1(1).

<sup>152</sup> *Ibid* ss 1(1) and 1(6), respectively.

<sup>153</sup> *Currency and Bank Notes Act, 1928* (UK), 18 & 19 Geo. V, c.13.

<sup>154</sup> *Ibid* s 2(1).

the Bank of England notes as legal tender. Thus, the Bank was expressly authorized to issue small amount notes.<sup>155</sup> In addition, notes of five pounds or more were declared to be legal tender for payment of any amount and not, as before, for amounts above five pounds.<sup>156</sup> The final development as to the exclusiveness of the Bank of England notes as paper money occurred in 1933, when the Bank fixed 31 July of that year as the last day on which Treasury notes would be legal tender.<sup>157</sup>

At its inception, the note-issuing power of the Bank of England was unregulated.<sup>158</sup> Effectively, this meant that no ceiling requirements restricted this power.<sup>159</sup> However, since 1844,<sup>160</sup> the ‘fiduciary issue’, that is, the issue of notes backed by securities and uncovered by gold and silver in reserve, became tightly controlled.<sup>161</sup> The scheme was reformed in 1928<sup>162</sup> when the Bank was required or authorized to issue notes either against gold in reserve, or as a fiduciary note issue to an amount controlled by Treasury and reported to Parliament.<sup>163</sup> The fiduciary note issue was required to be backed by securities.<sup>164</sup>

Nevertheless, irrespective of coverage or lack of coverage by precious metal in reserve, Bank of England notes have always contained an engagement to pay money. Indeed, the right of a holder of a banknote to demand coin, or the convertibility to metallic money, ‘had been an essential feature of the Bank of England Act 1833.’<sup>165</sup> In the absence of a requirement for the full metallic cover, fractional metallic reserves were available to meet reasonable demand for conversion by banknote holders; this was similar to the way that the fractional reserve of a bank is designed to be adequate to meet reasonable demand for withdrawals by depositors.

In the course of the eighteenth century, with gold coming to supplant silver as the monetary standard,<sup>166</sup> convertibility had come to be linked to gold. Convertibility to gold was honoured during World War I, but was subsequently overturned by the *Gold Standard Act, 1925*.<sup>167</sup> The statute ‘exempted the Bank of England from liability to redeem its notes with gold coin and merely placed

<sup>155</sup> *Ibid* s 1(1). A sweeping prohibition applying to any person to issue bearer demand notes for less than £5 each had existed since 1826. See Holden, above n 13 at 195.

<sup>156</sup> *Currency and Bank Notes Act, 1954* s 1(2), above n 138.

<sup>157</sup> For these developments, see Holden, above, n 13 at 278–80.

<sup>158</sup> See n 124 above.

<sup>159</sup> See Holden, above n 13 at 90.

<sup>160</sup> *Bank Charter Act, 1844*, above n 144. See ss 1–3.

<sup>161</sup> Holden, above n 13 at 196–97. See also Ferguson, above n 43 at 54–55.

<sup>162</sup> *Currency and Bank Notes Act, 1928*, above n 153. See ss 2, 8.

<sup>163</sup> See Holden, above n 13 at 280–81, where subsequent developments of the legislative scheme are given as well.

<sup>164</sup> *Currency and Bank Notes Act, 1928* s 3(1), above n 153. ‘Securities’ may include silver coin (*ibid* s 3(2)) as well as ‘securities and assets in currency of any country and in whatever form held’, *Finance Act, 1932* (UK), 22 & 23 Geo. V, c. 25, s 25(7), as amended by the schedule to the *Exchange Equalisation Account Act 1979* (UK), 1979, c. 30.

<sup>165</sup> C Proctor, *Mann on the Legal Aspect of Money*, 6th edn (Oxford: Oxford University Press, 2005) at 65. For suspensions of payment occurring prior to 1833, see Holden, above n 13 at 192–96.

<sup>166</sup> Feavearyear, above n 33 at 154.

<sup>167</sup> (UK), 15 & 16 Geo. V, c. 29. See Holden, above n 13 at 279.

it under the obligation to sell gold bullion at a fixed price and, moreover, granted to the Bank of England the exclusive right of obtaining coined gold from the Mint.<sup>168</sup> This 'limited convertibility' was abolished in 1931.<sup>169</sup> Effectively, the *Gold Standard (Amendment) Act, 1931*<sup>170</sup> ended the gold coinage in Great Britain.<sup>171</sup> This completed the process of placing paper money as a distinct specie of money, linked to metallic money only in its historical formation. Today, while section 1(3) of the *Currency and Bank Notes Act, 1954*<sup>172</sup> provides that notes issued by the Bank of England 'shall be payable' at the Bank, such payment can be made in the Bank's own notes.<sup>173</sup> At present, metallic money<sup>174</sup> is legal tender only for small amounts. Banknotes are legal tender to any amount.<sup>175</sup> Undoubtedly, banknotes have superseded coins as the principal form of cash.

### 3.3 Bank of England Becomes a Settlement Bank

Over the years, in connection with the payment system, the Bank of England became not only the issuer of banknotes, but also the provider of the superior settlement asset for interbank clearing. As set out below, this took place in a process that consolidated the Bank of England's position as a model modern central bank.

A settlement asset is the asset transferred among participants in a settlement system to settle payment obligations. It is the asset that extinguishes the payment obligation. In principle, it could be an asset such as gold, money, or credit to a bank account. Nonetheless, under Section IV of *Core Principles for Systemically Important Payment Systems*, '[a]ssets used for settlement should preferably be a claim on the central bank;<sup>176</sup> where other assets are used, they should carry little or no credit risk and little or no liquidity risk.'<sup>177</sup> In this context, 'credit risk' is the risk that a participant will be unable fully to meet its financial obligations within the system, either when due or at any time in the future. This is the same as insolvency risk. 'Liquidity risk' is the risk that a participant will have insufficient funds to meet financial obligations within the system as and when expected, although it may be able to do so at some time in

<sup>168</sup> Proctor, above n 165 at 65.

<sup>169</sup> *Gold Standard (Amendment) Act, 1931* (UK), 21 & 22 Geo. V, c. 46.

<sup>170</sup> *Ibid.*

<sup>171</sup> Holden, above n 13 at 279. Holden notes that a small issue was undertaken by the Royal Mint in 1949 to 'preserve the inherited knowledge and craftsmanship of gold coining.' *Ibid* at 279, fn 5.

<sup>172</sup> Above n 138.

<sup>173</sup> Proctor, above n 165 at 25, fn 97.

<sup>174</sup> Coinage issue is now largely regulated in England by statute. See *Coinage Act 1971* (UK), 1971, c. 24 as amended by the *Currency Act 1983* (UK), 1983, c. 9.

<sup>175</sup> *Ibid*; see Goode, above n 150 at 9. Gold coins fall into the same category as banknotes. But see n 171 and text above.

<sup>176</sup> In this context, reference is to the central bank of the currency, namely its issuer and on whose books reserve accounts of banks denominated in that currency are held.

<sup>177</sup> *Core Principles*, above n 96 at 3, 34.

the future. Unlike the credit (that is, insolvency) risk, liquidity risk is temporary; yet, settlement obligations are time sensitive, and hence the impact of the risk may be quite serious.<sup>178</sup>

Both credit and liquidity risks are effectively eliminated where the counterparty is the central bank. Its liability is of equal force and creditworthiness on both the banknote and the commercial bank's account held with it. As a practical matter, compared to a claim on a banknote issued by a central bank, a claim in an account held with a central bank is a superior settlement asset only because it bypasses the need for printing the banknote as well as its storage and transportation. The relative inferiority of gold or any other precious metal is attributed to the same drawbacks that led to the superseding of specie and coin as money.

Thus, the best settlement asset for interbank payment obligations is in the form of credit on settlement or reserve accounts that a central bank maintains for participating commercial banks. Such a 'settlement asset' is referred to as 'central-bank money', so as to be distinguished from 'commercial-bank money' in the form of credit given to a customer in an account maintained at a bank.<sup>179</sup> Certainly, 'central-bank money' is a safer asset than 'commercial-bank money'. This is so since a bank customer, holder of 'commercial-bank money', bears the risk of bank failure; such a risk, being both a liquidity and credit risk, is effectively non-existent for a bank holder of 'central-bank money'.<sup>180</sup> However, as a rule, in a modern banking and payment system, 'central-bank money' is available only to banks holding reserve or settlement accounts at the central bank, and not to the general public.<sup>181</sup>

Consisting of obligations incurred by the central bank, both 'central-bank money' and banknotes are not only of equal face value but also of equal (practically non-existing) risk; formed by the central bank's obligations, the 'monetary base' of a country nowadays thus consists of banknotes in the hands of the public and claims on accounts held at the central bank by commercial banks. Such obligations (always in the case of banknotes) do not bear interest, or at the most, in the case of 'central-bank money' (but as a rule, not banknotes), may bear very low interest. Other than when they reflect loans made by the central bank to commercial banks, these obligations are 'purchased' by commercial banks from the central bank with, or with what is mostly converted to, high-quality liquid assets, bearing interest at the prevailing market rate, such as government debt securities. These high-quality liquid assets are used by the central bank to back obligations on the monetary base. The revenue from such

<sup>178</sup> *Ibid* at 5.

<sup>179</sup> Manning, Nier and Schanz, above n 22 at 4.

<sup>180</sup> Accordingly, Implementation Summary of Core Principle VI for Systemically Important Payment Systems identifies 'a claim on the central bank issuing the relevant currency' as '[t]he most satisfactory settlement asset' for such systems. *Core Principles*, above n 96 at 36.

<sup>181</sup> For 'central-bank money' in general, also in relation to 'commercial-bank money', see eg Committee on Payment and Settlement Systems (CPSS), *The Role of Central Bank Money in Payment Systems* (Basel: Bank for International Settlements, August 2003).

high-quality liquid assets is higher than the sum of (i) the cost of printing as well as perhaps storage and other incidental costs associated with banknotes, and (ii) the low interest that may be payable on reserve accounts. The difference between these two amounts, namely, the income from the high-quality liquid assets and the sum of banknote costs together with, where applicable, interest on reserves, constitutes a profit of the central bank, or net revenue derived from issuing money; as a rule, the profit is to be transferred by the central bank to the Government. This profit is the modern-day 'seigniorage'.<sup>182</sup>

Unlike banknotes, 'central-bank money' is not available to the public, but rather solely to commercial banks holding accounts in the central bank. As such, unlike banknotes, 'central-bank money' is not part of the money supply. As explained below, in a process under which credit in an account maintained by it became the ultimate settlement asset, the Bank of England pioneered the issue of 'central-bank money'.

The role of the Bank of England as the provider of the standard interbank settlement asset evolved gradually.<sup>183</sup> Thus, as indicated,<sup>184</sup> prior to the establishment of the Bank of England, goldsmith-bankers settled bilaterally and in specie; that is, each pair of goldsmiths kept between them a running balance of amounts of customers' cheques deposited in one and drawn on the other. They settled on the difference periodically and in specie, usually coined money, paid by the net debtor to the net creditor. There was no formalized framework for the procedure; the frequency of each bilateral settlement depended on the size of the debt and the creditworthiness of the net debtor.

By itself, the establishment of the Bank of England did not change this procedure. At the same time, with the increase in the volume of transactions, thought was given to introducing greater efficiency and certainty. Possibly, the roots of the London Clearing House go back to '[n]ot many years after the London bankers had ceased to issue notes',<sup>185</sup> namely, 1750,<sup>186</sup> 'though its early days are shrouded in the darkest and most profound mystery.'<sup>187</sup> According to Lawson:<sup>188</sup>

<sup>182</sup> See eg A Berg and E Borensztein, *Full Dollarization: the Pros and Cons* (Washington DC: IMF, 2000) at 6, 16. For the ancient concept of seigniorage, as the ruler's profit from issuing coinage, see ch 2, section 1.1 above. Two meanings of seigniorage are also noted by [www.en.wikipedia.org/wiki/Seigniorage](http://www.en.wikipedia.org/wiki/Seigniorage). See Åke Lönnberg and K Sullivan, 'Seigniorage and Central Bank Accounting for Currency Issue', Unpublished IMF Technical Note, 31 July 2007 (Washington DC: International Monetary Fund). For 'seigniorage' with regard to metallic money in Antiquity and the Middle Ages, see ch 2, text around nn 21–29 (as well as around n 179) above.

<sup>183</sup> Manning, Nier and Schanz, above n 22 at 26.

<sup>184</sup> See text and nn 94–97 above.

<sup>185</sup> Lawson, above n 28 at 215.

<sup>186</sup> The year at which, according to Lawson, *ibid* at 213, private bankers in London 'totally ceased' to issue notes. See text at n 142 above.

<sup>187</sup> W Howarth, *Our Clearing System and Clearing Houses* (London: Effingham Wilson, 1884) at 26 (where the author attributes to Lawson the view that the origins of the Clearing House are shortly after 1755).

<sup>188</sup> Lawson, above n 28 at 215–16.

At first the system adopted was of the most primitive kind, and certainly not the safest. The clerks of the various banking-houses used to perform the operation of exchanges<sup>189</sup> at the corners of streets and on the top of a post; they then met by appointment at a public-house; but, from the insecurity of these arrangements, it was at last thought best that the principal city bankers should rent a house near the old Post Office in Lombard-street.

More specifically, in about 1770, Walk Clerks 'made a practice of meeting at lunch time at a public house' and gradually laid down the foundation of a regular exchange at a fixed place.<sup>190</sup> As of 1770, the banknote issued by the Bank of England replaced specie as the settlement asset. Around 1773, principal London bankers arranged for the rental of a room on Lombard Street where their clerks would meet to effectuate clearing and settlement. This was the official beginning of the London Clearing House. As of 1775, interbank settlement took place daily, and yet it continued to be carried out on a bilateral basis. Written clearing rules may have existed as of the early nineteenth century.<sup>191</sup>

The next turning point occurred in 1841 when the settlement became multilateral. Thus, with the view of reducing the number of payments and economizing on its use, each day, the position of each participating bank was to be calculated in relation to all others. Effectively, this must have been done in two stages. First, bilateral net positions were to be established for each participant towards each other. Second, for each participant, all bilateral positions were to be added, to form a single multilateral, either credit or debit, position, towards all others.<sup>192</sup> A net debtor paid the amount of his multilateral debit position to the Clearing House, which distributed the funds among net creditors, each receiving in the amount of his multilateral credit position. At this stage, for some time, the settlement asset remained the Bank of England banknote.

A major step occurred on 11 May 1854, following the admission to the Clearing House of joint-stock banks.<sup>193</sup> On that day, each net debtor participating bank paid the Clearing House the amount of his multilateral debit position by means of a cheque drawn on that debtor's account with the Bank of England. In turn, the Clearing House distributed the amount so paid by all net debtors. It issued to each net creditor participating bank a cheque drawn on the Clearing House's account with the Bank of England. This cheque was in the amount of that net creditor's multilateral credit position. Each such net creditor deposited the cheque it received from the Clearing House to his own account kept at the

<sup>189</sup> Certainly, reference is to manual exchange of instruments and not the Medieval exchange practice discussed above, particularly in ch 8 (and also ch 9).

<sup>190</sup> Matthews, above n 30 at 8, and see *ibid* at 1–18 for his account as to the origin of the clearing system.

<sup>191</sup> Matthews, *ibid* at 9.

<sup>192</sup> For a detailed analysis, see B Geva, 'The Clearing House Arrangement' (1991), 19 *Canadian Business Law Journal* 138.

<sup>193</sup> J Giuseppe, *The Bank of England: A History from its Foundation in 1694* (London: Evans Brothers, 1966) at 122–23. For consistency, I will continue to refer to a 'bank' as if it were a 'banker', namely as 'he' and not 'it'.

Bank of England. 'The risks attendant on the transport of actual bank-notes from the Clearing House to the banks, and *vice versa*, were thus eliminated, and a marked diminution . . . at once took place in the average circulation of the bank-notes of the Bank of England'.<sup>194</sup> In 1864 the Bank of England itself joined the Clearing House.<sup>195</sup>

The multilateral model persisted and proved advantageous even beyond attaining the obvious clearing efficiencies in the form of reduction of number of payments as well as of risk.<sup>196</sup> Unsurprisingly, it became a model for imitation;<sup>197</sup> thus, the New York Clearing House<sup>198</sup> was established in 1852;<sup>199</sup> in fact, by 1883 there were altogether 31 bank clearinghouses operating in the United States.<sup>200</sup> In Paris, the Bankers' Clearing House was established in 1872.<sup>201</sup> However, at its inception, taking into account the extent of non-uniform level of adherence to the English banking mode, the exact mechanism was not necessarily identical in all places. Thus, for example, in New York, in the absence of a central bank in the United States in the middle of the nineteenth century, settlement was not on the books of a central counterparty, but rather typically in specie.<sup>202</sup> It is only with the gradual expansion of the central bank system throughout the world that the English model, as a whole, decisively prevailed.

For its part, the Bank of England settlement system evolved and has been continuously refined. Particularly, settlement on the books of the Bank of England does not require cheques to be issued; rather, accounts are directly adjusted to reflect the positions of participants. Towards the close of the twentieth century, other clearing streams had been added, such as for electronic

<sup>194</sup> Martin, above n 5 at 173.

<sup>195</sup> *Ibid.*

<sup>196</sup> Eg, for the view that the evolution of commercial-bank clearinghouses 'reflects an endogenous "regulatory" response to the problems associated with the asymmetric distribution of information in the banking industry', see G Gorton and DJ Mullineaux, 'The Joint Production of Confidence: Endogenous Regulation and Nineteenth Century Commercial-Bank Clearinghouses' (1987), 19 *Journal of Money, Credit and Banking* 457. The quote is at 458. See also JT Moser, 'What is Multilateral Clearing and Who Cares?' *Chicago Fed Letter*, November 1994 (No 87, Federal Reserve Bank of Chicago). For a broader perspective covering financial contracts, see eg JT Moser and D Reiffen, 'Clearing and Settlement' in TW Kolb and JA Overdahl, *Financial Derivatives: Pricing and Risk Management* (Hoboken, NJ: John Wiley & Sons, 2010) ch 19 at 263.

<sup>197</sup> The principal features of the London Clearing House, as they were towards the end of the nineteenth century, are outlined by Howarth, above n 187 at 26–46, with more details set out in ensuing pages. For a modern perspective on the scope of operation of a clearing house, see eg HL Baer, VG France and JT Moser, 'What Does a Clearinghouse Do?' (Spring 1995), 1 *Derivatives Quarterly* 39.

<sup>198</sup> Its object was quoted in *O'Brien v Grant* (1895) 146 N.Y. 163 at 166 as the 'effecting at one place of the daily exchanges between the several associated banks, and the payment at the same place of balances resulting from such exchanges.' At present, it is common to distinguish between the exchange and calculation ('clearing') and payment ('settlement').

<sup>199</sup> Howarth, above n 187 at 162. According to WE Spahr, *The Clearing and Collection of Checks* (New York: Bankers Publishing, 1926) at 80, the year is rather 1853. His account on the origin of clearinghouses, albeit with emphasis on the US, is *ibid* at 69–83.

<sup>200</sup> Howarth, *ibid* at 193.

<sup>201</sup> *Ibid* at 150.

<sup>202</sup> *Ibid* at 186.



large-value transfers and bulk debit and credit transfers. In 1985, the Child Report was implemented<sup>203</sup> and the Clearing House was replaced by APACS, being the Association for Payment Clearing and Services. APACS was an unincorporated organization under whose umbrella the various clearing streams were incorporated. As of 2007, APACS has been superseded by the Payment Council, an organization that sets strategy for payment services in the United Kingdom.<sup>204</sup> For the electronic large-value payments, settlement is now carried out for each individual transfer on an RTGS, namely, a real-time gross settlement basis, rather than on the multilateral net basis of the cheque clearing system.<sup>205</sup> By late 2018, the cheque clearing system itself is scheduled for closure, as the paper cheque itself is being superseded by electronic media for the transmission of payment instructions.<sup>206</sup>

The clearing and settlement landscape thus continuously evolves; however, the fundamentals of the system, that is, its basic principles, remain as crystallized as in the middle of the nineteenth century. As such, albeit subject to some variations, particularly as to the role of the central bank in the operations of interbank payment systems and clearing,<sup>207</sup> this system spread out all over the globe to form the backbone of each national payment system.

### 3.4 Bank of England Becomes a Central Bank

Certainly, the use of bankers' accounts kept at the Bank of England for inter-bank settlement is a matter of efficiency. However, the move to this method of settlement could not have happened without the Bank of England becoming a bankers' bank, thereby also implementing important public policy objectives through accounts it maintains on its books for commercial banks.<sup>208</sup> Indeed,

<sup>203</sup> Bankers Clearing House, *Payment Clearing Systems: Review of Organisation, Membership and Control* (London: Banking Information Service, 1984) (after DM Child, Chairman of the Working Party).

<sup>204</sup> For a brief review (up to before the establishment of the Payment Council) see EP Ellinger, E Lomnicka and R Hooley, *Ellinger's Modern Banking Law*, 4th edn (Oxford: Oxford University Press, 2006) at 7–8. For the Payment Council, see [www.paymentscouncil.org.uk/](http://www.paymentscouncil.org.uk/).

<sup>205</sup> This is the CHAPS system, discussed in B Geva, *The Law of Electronic Funds Transfers* (New York: Matthew Bender, 1992–2010, looseleaf) at §4.04[3]. RTGS solves two drawbacks of the deferred net settlement system, which are the risk of participant's default and the occurrence of finality only upon the completion of settlement following the end of the (daily) cycle; yet RTGS raises problems of its own, such as cost, dependence on sophisticated technologies, liquidity shortfalls, and gridlocks. Solutions are costly and are used only for the wholesale high-value time sensitive (and not retail) payment systems.

<sup>206</sup> For a news item (emanating from Reuters, dated 16 December 2009) reporting the decision of the Board of the UK Payments Council to wind up the cheque clearing system on 31 October 2018, see [www.newsmax.com/Newsfront/britain-checks-electronicpayment/2009/12/16/id/343513](http://www.newsmax.com/Newsfront/britain-checks-electronicpayment/2009/12/16/id/343513).

<sup>207</sup> See S Millard and V Saporta, 'Central Banks and Payment Systems: Past, Present and Future' in Haldane, Millard and Saporta, above n 118 at 15; and for a brief summary, Manning, Nier and Schanz, above n 22 at 10.

<sup>208</sup> I use the term 'commercial banks' interchangeably with 'banks' to distinguish them from the central bank.

goldsmiths had kept accounts with the Bank of England as of its early days;<sup>209</sup> furthermore, the Bank of England aimed from its inception to become a bankers' bank and as such to contribute to the solvency of banks. However, it was primarily in the process of becoming a lender of last resort, designed to inject liquidity to illiquid banks by lending to them where the market failed to do so, that all banks became linked through the Bank of England into a cohesive 'banking system' functioning as more than the total sum or mere collection of its participating banks.<sup>210</sup>

The process was gradual; its origins are traced to the end of the eighteenth century.<sup>211</sup> However, it took place throughout the course of the nineteenth century, and is said to have been confirmed only towards its end.<sup>212</sup> In its course, benefits associated with an account with the Bank of England became obvious to each major bank; this led to the 'upgrade' of the entire account network held on the books of the Bank of England as well as to increased dependence on it by each bank.

Indeed, lending-of-last-resort is a task needed for a banking system premised on fractional reserves. Stated otherwise, a bank may be solvent and still unable to meet an unanticipated demand for withdrawals. The fulfilment of the lending-of-last-resort task requires monopoly over the issue of currency. It is a monetary rather than a banking or credit function designed to prevent panic-induced contraction in the amount of money on deposit with commercial banks. It applies to all monetary regimes, whether a metallic or an inconvertible paper currency regime, and does not conflict with the monetary control function. The lender of last resort is to act for the benefit of the entire economy and not individual banks. Finally, proper lending-of-last-resort can be accomplished either through open-market operations or loans made with a penalty rate.<sup>213</sup> The task is thus most efficiently carried out in conjunction with the conduct of monetary policy<sup>214</sup> and oversight of banks, all of which is enhanced by an efficient network of settlement accounts for large commercial banks; taken together, this ensemble constitutes the backbone of central banking.

Besides serving the lending-of-last-resort function, the network became indispensable not only for interbank settlement, but also as a conduit for the

<sup>209</sup> See text at n 133 above.

<sup>210</sup> Cairncross, above n 104 at 56, 60. For a modern perspective, see eg A Campbell and R Lastra, 'Revisiting the Lender of Last Resort' (2008–09), 24 *Banking and Finance Law Review* 453.

<sup>211</sup> The coining of the term is attributed to Sir Francis Barings in 1797. See TM Humphrey and RE Keleher, 'The Lender of Last Resort: A Historical Perspective' (1984), 4:1 *Cato Journal* 275 at 282. Other historical studies include MC Lovell, 'The Role of the Bank of England As Lender of Last Resort in the Crises of the Eighteenth Century' (1957) 10 *Explorations in Entrepreneurial History* 8 and M Collins, 'The Bank of England as Lender of Last Resort, 1857–1878' (1992), 45:1 *Economic History Review* 145.

<sup>212</sup> Thus, in the Baring Crisis of 1890, the Bank of England's 'intervention successfully avert[ed] threat to banking system and confirm[ed] its role as lender of last resort.' Roberts and Kynaston, above n 104, Appendix 1: Chronology at 225, 233.

<sup>213</sup> Humphrey and Keleher, above n 211 at 305–07.

<sup>214</sup> See eg MJ Artis, *Foundations of British Monetary Policy* (New York: AM Kelly, 1965).

principal role of a modern central bank in implementing its monetary policy. In this role a central bank acts as the guardian of the domestic price stability. Thus, an overall increase in the general level of prices expresses inflation, namely, a sustained decline in the value of the currency, leading to undesirable impoverishment and uncertainty. At the same time, deflation, as a general and sustained decline in prices, does not reflect a desired increase in the value of the currency; rather deflation stifles economic growth as it causes the public to hold off purchases in anticipation for further price decline. Hence, in guarding the internal value of the currency issued by it, namely, in maintaining price stability, a central bank combats both inflation and deflation.<sup>215</sup> What follows is an overview of the mechanism under which a central bank carries out this task.

As indicated below, it is a basic tenet of economics that the internal value of money, namely, the price level in the economy, hinges on the amount of money in circulation. To that end, from its early days, the Bank of England was reputed to have the power to set the value of its money by controlling its amount. First, it was reputed to have the power to do so on the basis of its original unlimited power to issue banknotes. Later, the power was reputed to be based on the position of the Bank of England as the single largest holder of money; as such, it was reputed to be able to affect the value of money the way a large holder of any commodity may affect its price. In effect, the power has always had to do with the ability of the Bank of England to affect interest rates, originally through discounting bills of exchange.<sup>216</sup> Regardless, 'the Bank of England has [no] despotism in that matter';<sup>217</sup> rather, its power in implementing a monetary policy has been to influence or impact, but strictly speaking, not to 'control'.

During the nineteenth century monetary policy was implemented through actual lending against bills of exchange reflecting transactions in real goods. Banks which either over-lent against, or under-collected on, such bills, borrowed from the Bank of England rediscounting to it good bills of exchange originally discounted to them by merchants. Loans were in the form of newly issued banknotes. The effective limit to the Bank of England's power to issue banknotes to be lent against such bills was the anticipated demand for gold, in effect, particularly by foreigners, to which such banknotes could be converted. Today monetary policy is implemented effected particularly through trading in government securities between the central banks and commercial banks and offering by the former to the latter short-term loans for the purchase of such securities.

<sup>215</sup> See eg Article 2 of ECB, *Protocol on the Statute of the European System of Central Banks and of the European Central Bank*, [1992] O.J. C 191/68 (29 July 1992), stating that 'the primary objective of the [European System of Central Banks] shall be to maintain price stability.' For the monetary-policy objective as 'usually cast in terms of price stability', see Manning, Nier and Schanz, above n 22 at 32.

<sup>216</sup> See Bagehot, above n 106 at 113–21. Bagehot explains that the Bank of England has the power to affect the discount rate, since '[a]t all ordinary moments there is not money enough in Lombard Street to discount all the bills in Lombard Street without taking some money from the Bank of England.' *Ibid* at 114.

<sup>217</sup> Bagehot, *ibid* at 118.

Proceeds of such loans are not in the form of banknotes, but rather, in the form of deposits on the books of the central bank. The loans are secured by government securities and their proceeds are used by borrowing banks primarily to finance transactions in government securities. By setting the rate for loans used for acquiring deposits on the books of the central bank, the central bank controls the amount of such deposits, thereby affecting the rate for the interbank unsecured short-term lending of such deposits.<sup>217.1</sup> In turn, in a process reinforced by market operations of the central bank, discussed below, this interbank lending rate affects the quantity of money in the economy.

In the present elaborate financial system, the mechanism for the implementation of the monetary policy uses the commercial bank settlement accounts network as a conduit and is quite complex. As in the early days, the mechanism hinges on the central bank's ability to contribute to the regulation of the money supply. As a rule, the money supply (or monetary stock) consists of currency (banknotes and coins) held by the public and 'commercial-bank money', that is, deposits of the public in commercial banks. It is to be distinguished from the 'monetary base', consisting of banknotes and funds on deposit with the central bank held by commercial banks in settlement or reserve accounts. The money supply directly influences the price level in the economy; a greater amount correlates with high prices and vice versa, lower amounts correlate with low prices. The money supply also affects, and is affected by, interest rates, which can be described as the cost of money to the public. Thus, there is a correlation between high interest rates and a decrease in the money supply; vice versa, there is a correlation between low interest rates and an increase in the money supply. In turn, interest rates further affect investment, national income and employment. In turn, as explained below, the amount of 'commercial-bank money' is a derivation from the amount of 'central-bank money'.<sup>218</sup>

Until recently, monetary policy tools were designed to affect the amount of 'commercial-bank money' and interest rates. The principal monetary policy tools available to a central bank were changes in the bank rates, transfer of government deposits, and open market operations.<sup>219</sup>

First, the 'bank rate' is the interest rate the central bank charges for advances it makes to commercial banks. It is designed to be higher than the market rate so

<sup>217.1</sup> For a recent analysis (including an explanation of how it all broke down in the then most recent financial crisis), see P Mehrling, *The New Lombard Street: How the Fed Became the Dealer of Last Resort* (Princeton and Oxford: Princeton University Press, 2011) 18–29.

<sup>218</sup> For a detailed economic perspective, see eg H Binhammer and PS Septon, *Money, Banking and the Canadian Financial System*, 8th edn (Scarborough, Ont: Nelson, Thomson Learning, 2001) at 197–219 (banking and the creation of money), 387–432 (monetary controls and central banking). For whether the monetary base control is the right means for controlling the monetary aggregates see MDKW Foot, CAE Goodhart and AC Hotson, 'Monetary Base Control' (1979), 19:1 *Bank of England Quarterly Bulletin* 149. For 'commercial-bank money' and 'central bank money' see above, text at n 179.

<sup>219</sup> See eg D Stager, *Economic Analysis and Canadian Policy*, 7th edn (Toronto: Butterworths, 1992) at 183–91 (techniques for regulating the money supply), 195–96 (correlation between money supply and price level); and 239–42 (monetary policy).

as to deter banks from borrowing from the central bank. In turn, by raising and lowering the bank rate, the central bank signals the level of interest rates it anticipates to prevail in the market. Second, as banker to the Government, the central bank is able to move government deposits between itself and commercial banks so as to lower or raise the amount of deposits maintained in banks. Third, through open market operations, the central bank purports to influence the amount of ‘central-bank money’ on which the amount of ‘commercial-bank money’ depends.

However, by the mid-1980s, it became clear that, on its own, quantitative monetary targeting had failed as a nominal anchor for central bank policy. This is generally attributed to a wave of financial innovation by banks and other financial entities that resulted in important changes in the way that the public held their financial assets, significantly affecting the various measures of money. The proximate instrument used by central banks for inflation targeting became changes in a policy rate, in the form of a short-term rate of interest, often the overnight rate. At the same time, it is again by means of open market operations that a central bank is able to influence the desired rate. In the process, the central bank still impacts the amount of ‘commercial-bank’ money, albeit the control of this amount is no longer an independent objective.

Open market operations are by far the principal tool for a central bank to implement its monetary policy. They consist of trades between the central bank and commercial banks in government debt securities which are settled in central-bank money. Such trades are reflected in changes in the central bank’s balance sheet. The amount of central-bank money (that is, balances in reserve accounts of commercial banks) resulting from such trades is of particular importance. Due to the central bank monopoly on central-bank money, a small modification to that amount translates into a much larger change in the amount of commercial-bank money and, hence, in the amount of the money supply.<sup>220</sup>

Thus, in the typical model, in the assets side of the balance sheet of a central bank appear items such as (i) precious metals, usually in the form of gold bullion, physically placed at the vaults of either the Bank of England or the Federal Reserve Bank of New York; (ii) liquid foreign reserves in the form of

<sup>220</sup> See eg BM Friedman, ‘The Future of Monetary Policy: The Central Bank as an Army with Only a Signal Corps?’ (1999), 2:3 *International Finance* 321 at 323–26; C Freedman, ‘Monetary Policy Implementation: Past, Present and Future – Will Electronic Money Lead to the Eventual Demise of Central Banking?’ (2000), 3:2 *International Finance* 211 at 212–17; and C Freedman and D Laxton, ‘Why Inflation Targeting?’ IMF Working Paper No 09/86, April 2009, available at [www.imf.org/external/pubs/ft/wp/2009/wp0986.pdf](http://www.imf.org/external/pubs/ft/wp/2009/wp0986.pdf). By means of such operations, the Bank of England supports its ‘bank rate’, namely, the interest rate that it charges banks for secured overnight lending that, as explained in the text that follows, is ‘transmitted’ so as to implement the monetary policy objectives. For details, see eg Bank of England, *The Development and Operation of Monetary Policy 1960–1983* (Oxford: Clarendon Press, 1984) (being a selection of material from the *Quarterly Bulletin* of the Bank of England). For operations while the gold standard was in force, see eg RS Sayers, *The Bank of England 1891–1944* (Cambridge: Cambridge University Press, 1976) vol I at 37–43; and in more detail by the same author, RS Sayers, *Bank of England Operations 1890–1914* (Westport, Conn: Greenwood Press, 1970, reprint of 1936 original).

high-quality foreign currency bonds or deposits; (iii) domestic (home) government debt securities; and (iv) loans to commercial banks as well as (v) loans to the Government. The liability side of the central bank's balance sheet shows items such as (i) deposits held by commercial banks (in reserve or settlement accounts), (ii) government deposits, and (iii) banknotes (currency) held by the public.

Funds held on deposit with the central bank are not held by the public; they are 'sterilized' and thus do not constitute a part of the money supply. The implementation of the monetary policy is determined by the central bank's ability to cause movements in its balance sheet between the securities (and loans to commercial banks) in the assets side and settlement balances ('central-bank money') in the liabilities side. This is carried out by trading with banks in securities for which payment is made in 'central-bank money', namely, out of and into the settlement accounts. Thus, when the central bank sells securities to commercial banks, the amount of their reserve deposits ('central-bank money') decreases. When the central bank buys securities from commercial banks the amount of their reserve deposits ('central-bank money') increases.

For commercial banks, loans to the public are assets. As a rule, proceeds of such loans are deposited to borrowers' accounts so as to increase the amount of 'commercial-bank money'. The supply of money lent, and hence the supply of 'commercial-bank money', is not completely at the discretion of commercial banks. Rather, it is effectively linked to the size of resources available to the bank, specifically, that of reserves, namely to that of 'central-bank money'. Accordingly, a decrease in the amount of reserve deposits (namely, a decrease in 'central bank-money') results in a decline in the amount of 'commercial bank' money available to the public; it may also require banks to borrow (at a penalty rate) from the central bank newly created settlement balances. Either way, this is transmitted to the economy in the form of higher interest rates, which in turn reduce the demand for 'commercial-bank money'. Conversely, an increase in the amount of reserve deposits (namely, an increase in 'central bank-money') results in a rise in the amount of 'commercial bank' money available to the public and is thus transmitted in the form of lower interest rates, which increase demand for 'commercial-bank money'.<sup>220.1</sup> Thus, a decrease in 'central-bank money' results in a corresponding decrease in the amount of 'commercial-bank money' available at a high interest rate; conversely, an increase in 'central-bank money' results in a rise in the amount of 'commercial-bank money' available at a low interest rate.

<sup>220.1</sup> However, in exceptional circumstances, banks concerned with their own financial health may prefer to hold the extra reserves without expanding lending. On such occasion the central bank may inject money into the economy by buying government debt instruments directly from the wider economy rather than the banks. This practice is called 'Quantitative Easing' (QE). See eg Bank of England, *Quantitative Easing Explained: Putting More Money in the Economy to Boost Spending* (2009), available online at [www.bankofengland.co.uk/monetarypolicy/pdf/qe-pamphlet.pdf](http://www.bankofengland.co.uk/monetarypolicy/pdf/qe-pamphlet.pdf).

What has been crucial for the implementation of monetary policy has been the combination of the monopoly power of the central bank over the supply of reserves or settlement balances and its ability to impose terms and conditions related to the excess or shortfall of reserves or settlement balances. Together, these have determined the incentives for banks to adjust their balance sheets in response to central bank actions.

In both countries with and without reserve requirements, central banks' open-market operations are the key for the implementation of monetary policy. Thus, in countries with reserve requirements, open-market operations allow central banks to control the total supply of reserve. Hence, central banks are able to create an excess or deficiency of reserves for commercial banks. Incentives facing commercial banks when they have a surplus or deficit of deposits at the central bank are equally important in explaining the influence of central banks over the very short-term interest rate. These incentives depend on terms and conditions imposed by the central bank. The key element in the response of banks to a surplus of deposits is the rate of interest paid on those deposits. Thus, if excess deposits bear no return, explicitly or implicitly, banks will take action to exchange them for assets that do carry a return. This will lead to a decline in interest rates and, over time, to an increase in spending. This process will work even if excess deposits have a positive rate of return, provided that the rate of return on such excess deposits is below the market rate of interest, thereby leaving some incentive for banks to increase their earnings by substituting assets bearing market rates of return for excess deposits bearing below-market rates of return.

These incentives facing banks are also a key factor in understanding the way they react when they have a shortfall of deposits at the central bank. Because the central bank is the only source of reserves to the system as a whole, when there is an overall deficiency in deposits some banks will have to borrow from the central bank on terms and conditions imposed by the latter. In most cases, the central bank imposes a penalty rate on such borrowing, that is, a rate sufficiently above the market rate to encourage banks to try to avoid such an outcome by acting to eliminate the deficiency, say by selling securities, thereby putting upward pressure on interest rates.

In countries in which commercial banks do not need to meet reserve requirements, the central bank is still able to maintain its influence over the policy rate. The key element in the central bank's continuing influence lies in the fact that commercial banks use transfers of the settlement balances that they hold on deposit at the central bank to settle imbalances in net payment flows. In addition, the central bank can set the incentives so that banks react to an excess or shortfall of settlement balances in a way that gives rise to downward or upward pressure on the policy rate.

Open-market operations conducted by the central bank play an important role also in such countries. These operations serve as an incentive for banks to reduce the amount of settlement balances available to a level lower than that



desired by them. Because the central bank is the only source of settlement balances, this shortfall forces banks to borrow from the central bank at terms and conditions of the central bank's choosing. These terms and conditions create incentives for the banks to react to central bank actions. Thus, the central bank can effect an increase in the very short-term interest rate by raising the rate at which it is prepared to lend to banks facing a shortfall of settlement balances.

In recent years, in countries without reserve requirements, the emphasis has been placed on an announced level or an announced band or corridor for the policy rate. Before that, in carrying out open market operations, the central bank more or less achieved its desired outcome for the policy rate, as long as its estimate of the demand for reserves or settlement balances was accurate. At present, in many countries, the central bank simply announces its target for the policy rate and, effectively, supplies the amount of settlement balances needed to meet the demand at the target level.

Price stability became the main responsibility of a central bank only with the abandonment of convertibility; the latter required a central bank to focus on the maintenance of the rate of exchange vis-a-vis gold.<sup>221</sup> However, already as of the nineteenth century the Bank of England developed various market techniques involving the repurchase of government securities as well as collateralized lending against such securities.<sup>222</sup> Surely its role as the Government's agent in financial markets was instrumental in according to it important functions in money and capital markets; and yet, the account network of participating major banks facilitated the process. 'As repository of the cash reserve of the banking system and banker to the government,' the Bank of England 'alone had the resources to meet the demand for cash in times of panic'<sup>223</sup> as well as to implement effective monetary policy. It was in this environment that 'central-bank money' became the ultimate settlement asset.

In the final analysis, the central-bank account network for participating major banks serves as a reservoir for 'central-bank money'; as such it facilitates loans of 'last resort', open market operations, as well as interbank transactions and settlement. It also positions the central bank as an overseer of the payment system and possibly even a regulator of the financial system and a guardian of its stability.<sup>224</sup> To that end, this account network provides for the infrastructure

<sup>221</sup> Cairncross, above n 104 at 58. For monetary policy during the last period of convertibility, namely, the gold standard, see eg Sayers, *Bank of England Operations*, *ibid*. Note that internationally, the gold standard was originally replaced by the gold-exchange standard, under which the value of domestic currency was linked to a major currency, first the UK pound sterling and subsequently the US Dollar, whose own value was linked to gold. At least indirectly, then, the gold standard lasted until the collapse of Bretton Woods. For the history of international arrangements see RM Lastra, *Legal Foundations of International Monetary Stability* (Oxford: Oxford University Press, 2006) at 345–70.

<sup>222</sup> See eg D Kynaston, 'The Bank of England and the Government' in Roberts and Kynaston, above n 104 at 19, 25–29; and Cairncross, *ibid* at 58–61, 73–82. See also Manning, Nier and Schanz, above n 22 at 33.

<sup>223</sup> Roberts, above n 114 at 177.

<sup>224</sup> See above, text around n 102.

required for the operational services and all other functions of a central bank. Stated otherwise, the creation of the account network and the transformation of the Bank of England into a central bank were interactive, with one process reinforcing and being reinforced by the other. While the transformation was formalized only in the nationalization of the Bank of England in 1946,<sup>225</sup> the model had been gradually established earlier, mostly during the nineteenth century. The assumption of the settlement function by the Bank of England was thus an integral part, both a cause and a result, of its transformation.

#### 4. PAPER MONEY AND THE PROMISE TO PAY MONEY: ARE BANKNOTES 'PROMISSORY NOTES'?

In his monumental classic work, Adam Smith spoke very favourably of paper money. In his view:

The substitution of paper in the room of gold and silver money, replaces a very expensive instrument of commerce with one much less costly, and sometime equally convenient. Circulation comes to be carried by a new wheel, which it costs less both to erect and to maintain than the old one.<sup>226</sup>

Having recognized that paper money increases the money supplied, he was further cognizant of the fact that the power to issue paper money is not unlimited; that is, an issuer is to maintain a metallic reserve adequate to meet a reasonable demand for conversion; any additional paper would require 100 per cent reserve.<sup>227</sup> However, he added, '[t]he whole paper money of every kind which can easily circulate in any country never can exceed the value of the gold and silver of which it supplies the place.'<sup>228</sup>

In principle, and as confirmed by history, paper money need not necessarily exclusively be confined to banknotes.<sup>229</sup> Reference was already made in this

<sup>225</sup> *Bank of England Act, 1946* (UK), 9 & 10 Geo. VI c. 27. See Kynaston, above n 222 at 19, 29, and Roberts, above n 114 at 179.

<sup>226</sup> Smith, above n 48 at 309. As banknotes are less heavy than coins I am not sure why he says that, by comparison to metal, paper money is only 'equally convenient' rather than 'more convenient'.

<sup>227</sup> Smith, *ibid* at 320 where he gives the following example: 'suppose that all the paper of a particular bank which the circulation of the country can easily absorb and employ, amounts exactly to forty thousand pounds; and that for answering occasional demands, this bank is obliged to keep at all times in its coffers ten thousand pounds in gold and silver. Should this bank attempt to circulate forty-four thousand pounds. . . [it] ought to keep at all times in its coffers, not eleven thousand pounds only, but fourteen thousand pounds.'

<sup>228</sup> Smith, *ibid* at 318. I take him to mean that paper money does not increase monetary demand, but rather (together with anything else which is money, such as coins), satisfies it. Adam Smith's specific formulation on the point is however criticized by H Thornton, *An Enquiry into the Nature and Effects of the Paper Credit of Great Britain* (1802) (New York: AM Kelley, 1962, edited with Introduction by FAV Hayek) at 94–96, pointing out that having broadly defined paper money to include bills of exchange payable in a future date, Adam Smith should have taken into account the different speed of circulation between such instruments and banknotes payable to bearer.

<sup>229</sup> For a recent vehement endorsement of government-issued, as superior to bank-issued, paper money see EH Brown, *The Web of Debt*, 3rd edn Revised and Expanded (Baton Rouge, La.: Third

chapter to the Chinese experiments of the twelfth to fourteenth centuries,<sup>230</sup> as well as to the fact that Exchequer orders, reflecting claims to government revenue, circulated in England during the seventeenth century.<sup>231</sup> In the United States, Greenback dollars, namely, inconvertible government bills serving as money during the second half of the nineteenth century, were forerunners for Reserve dollar notes that we know today.<sup>232</sup>

As well, in Canada, prior to the establishment of a central banking system in 1934, paper money consisted not only of banknotes, intended for circulation and issued by the chartered banks, but also of Dominion Notes issued by the Government of Canada.<sup>233</sup> Coins and Dominion Notes, but not banknotes, constituted legal tender.<sup>234</sup> Dominion Notes and banknotes carried a payment promise.<sup>235</sup> Dominion Notes were 'redeemable in gold', with 'gold' being defined as 'gold coins which are a legal tender in Canada' and 'gold bullion in bars', each stamped by a minting authority in the UK, Canada, Australia, or the US.<sup>236</sup> Banknotes were payable in coin,<sup>237</sup> and under some circumstances in Dominion Notes.<sup>238</sup>

Indeed, possibly, having in mind particularly bills of exchange payable on a future date, already in the course of the eighteenth century, Adam Smith recognized that '[t]here are several different sorts of paper money'; at the same time, he acknowledged that 'the circulating notes of banks and bankers are the species which is best known, and which seems best adapted' to substitute and 'have the same currency as gold and silver money.'<sup>239</sup> This has been confirmed by

Millennium Press, 2008), who speaks at 222 of President Lincoln as having 'stood up to the bankers, rejecting their usurious loans in favor of government-issued Greenbacks', and at 223 of 'debt-free government-issued money [as] the cornerstone of the American Revolution.' She carries her anti-bank campaign as far as to give credence to a theory under which Wall Street financiers actively supported the 1917 Bolshevik Revolution in Russia. *Ibid* at 224–25.

<sup>230</sup> See text at nn 17–20 above.

<sup>231</sup> See text at nn 120–21 above.

<sup>232</sup> Eagleton and Williams, above n 19 at 230–34; and in detail: WC Mitchell, *A History of the Greenbacks: With Special Reference to the Economic Consequences of Their Issue: 1862–65* (Chicago: University of Chicago Press, 1903).

<sup>233</sup> See M Kianieff, 'Private Banknotes in Canada from 1867 (and Before) to 1950' (2004), 30 *Queen's Law Journal* 400. For a concise history of the Canadian paper money, see *Bank of Canada v Bank of Montreal* (1977), [1978] 1 S.C.R. 1148, 76 D.L.R. (3d) 385 at 1166–68 (S.C.R.), 397–98 (D.L.R.) per Beetz J; 1156–57 (S.C.R.), 390 (D.L.R.) per Laskin C.J.C. For banknotes in Canada under present law, see B Crawford, *The Law of Banking and Payment in Canada* (Aurora, Ont: Canada Law Book, 2008, Looseleaf) vol III at §35:10.30(2).

<sup>234</sup> See JD Falconbridge, *Banking and Bills of Exchange*, 5th edn (Toronto: Canada Law Book Company, 1935) at 141–42. The *Bank Act*, R.S.C. 1927, c. 12, ss 61–74; *Dominion Notes Act*, R.S.C. 1927, c. 41; *Currency Act*, R.S.C. 1927, c. 40.

<sup>235</sup> This was noted by Laskin C.J.C. in *Bank of Canada v Bank of Montreal*, above n 233 at D.L.R. 390. Banknotes were 'payable to bearer on demand.' *Bank Act*, *ibid* at s 61. The form of Dominion Notes 'shall be . . . as the Minister [of Finance] directs.' *Dominion Notes Act*, *ibid* at s 4.

<sup>236</sup> *Dominion Notes Act*, *ibid* at ss 4(3), 2(b). An earlier Act provided that Dominion Notes were redeemable 'in specie', ie, in coin or bullion. R.S.C. 1906, c. 27, ss 4(2), 2(a).

<sup>237</sup> Like any other payment governed by the *Currency Act*, above n 235.

<sup>238</sup> *Bank Act*, above n 234 at s 71.

<sup>239</sup> Smith, above n 48 at 310.

history; particularly with the global ascent of central banking, the banknote came to dominate. Over the years, throughout the world, banknotes have become predominantly, or even almost exclusively, inconvertible.<sup>240</sup> As for its text, a banknote may merely be denominated in a specific sum of money; alternatively, it may expressly be stated to be payable, in its denominated amount, to bearer on demand. In practice, it neither bears interest<sup>241</sup> nor states a due date, and certainly is never made payable to a particular person or order. It is issued by the central bank,<sup>242</sup> which is thus deemed to be liable on it; however, the banknote may be made by statute the obligation of the state itself,<sup>243</sup> albeit, as a rule, this obligation does not appear on the banknote. The banknote is often defined as '[a] bank-issued promissory note that is payable to bearer on demand and that may circulate as money.'<sup>244</sup> An issue to be discussed below is whether a banknote is truly a 'promissory note' of the issuing central bank, subject to statutory provisions governing in general notes payable to bearer on demand.<sup>245</sup>

The issue does not arise in a jurisdiction whose promissory notes legislation is based on the *Geneva Uniform Law for Bills Convention*.<sup>246</sup> This is so since, under the *Convention Providing a Uniform Law for Bills of Exchange and*

<sup>240</sup> But *cf* banknotes payable in banknotes of another currency. Such are Scottish banknotes, payable in pound sterling, which are not legal tender. See n 149 above. Also banknotes in a domestic currency pegged to another (foreign) currency, which themselves may be legal tender, may (albeit not necessarily) be payable in (namely, redeemable to) the (foreign) currency to which the banknotes are pegged. See eg WL Coats, 'The Central Bank of Bosnia and Herzegovina: Its History and Its Issues' in MI Blejer and M Škreb (eds), *Central Banking, Monetary Policies, and the Implications for Transition Economies* (Boston: Kluwer Academic Publishers, 1999) at 367, 395–96.

<sup>241</sup> As such its holder 'makes haste to part with it' so that it circulates better than the interest bearing bill of exchange payable in a specific future date. Thornton, above n 228 at 93.

<sup>242</sup> But *cf* the position in Hong Kong, where banknotes are issued by designated commercial banks against Certificates of Indebtedness denominated in foreign currency issued to those banks by a Currency Board against payment of the amount in the foreign currency. See J Yam, 'Review of Currency Board Arrangements in Hong Kong' (Monetary Authority of Hong Kong, 5 December 1998) at 30.

<sup>243</sup> Eg, US *Federal Reserve Act*, c. 6, 38 Stat. 251, s 16(1) (codified as amended at 12 U.S.C. 226 (1913)) provides that Federal Reserve notes 'shall be the obligations of the United States . . . They shall be redeemed in lawful money on demand at the Treasury Department of the United States, in the city of Washington, District of Columbia, or at any Federal Reserve bank.' They are legal tender under the *Coinage Act*, Pub. L. No. 89-81, §31, 79 Stat. 254 (1965). The abolition of convertibility goes back to s 6 of *An Act to protect the currency system of the United States, to provide for the better use of the monetary gold stock of the United States, and for other purposes*, being Chapter 6, passed 30 January 1934, 73rd Congress, Sess. II, Chs 4–6, [HR 6976] [Pub. L. No. 87]. Thereunder, 'Except to the extent permitted in regulations . . . no currency of the United States shall be redeemed in gold.' Such regulations have not been issued; they may be issued by the Secretary of the Treasury and require approval by the President.

<sup>244</sup> *Black's Law Dictionary*, above n 134 at 166.

<sup>245</sup> Certainly, in principle, the discussion applies also to 'currency notes' issued by the Government itself, as eg, the pre-1934 Dominion notes in Canada discussed above.

<sup>246</sup> *Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes*, 7 June 1930, 143 L.N.T.S. 257, Annex I (hereafter: Bill Convention, or ULB). For the Geneva Convention's legal systems, see P Ellinger, 'Negotiable Instruments' in JS Ziegel (chief ed), *Commercial Transactions and Institutions*, vol IX of U Drobnič and K Zweigert, (responsible eds), *International Encyclopedia of Comparative Law* (Tübingen: JCB Mohr, 2000) ch 4 at 56–80 (hereafter: Ellinger, 'Negotiable Instruments').

*Promissory Notes* (ULB), article 75(1), no instrument can be a 'promissory note' unless it contains the term 'promissory note'. Moreover, the ULB does not provide for a promissory note payable to the bearer; rather, article 75(5) requires the identification of a payee. A banknote is unlikely to be titled 'Promissory Note' and is not stated to be payable to a particular person. As such it cannot be a 'promissory note' under the ULB.

In the United States, and in contrast to the ULB, Article 3 of the *Uniform Commercial Code*, governing promissory notes,<sup>247</sup> provides for notes payable to the bearer on demand.<sup>248</sup> This would have opened the issue as to the characterization of the banknote. However, the *Uniform Commercial Code*, §3-102(a) explicitly excludes 'money' from the coverage of Article 3 governing bills ('drafts'), cheques, and notes.<sup>249</sup> According to Official Comment 1 to its predecessor,<sup>250</sup> this exclusion is notwithstanding the fact that 'money may be in the form of a banknote which meets all the requirements' as to the form of a negotiable instrument, effectively, a promissory note.<sup>251</sup>

The likely model for the predecessor of the American *Uniform Commercial Code*,<sup>252</sup> is the English *Bills of Exchange Act* in England.<sup>253</sup> The latter is also the ancestor of statutes enacted in numerous jurisdictions.<sup>254</sup> It does not require the insertion on a note of a 'promissory note' title. Section 83(1), defining 'promissory note', further recognizes notes payable to the bearer on demand.<sup>255</sup> In the absence of a provision in the *Bills of Exchange Act* that corresponds to the *Uniform Commercial Code* §3-102(a), the question as to whether the banknote is a promissory note does not benefit from a direct statutory answer.

Indeed, in England, under the *Bills of Exchange Act*, having met the required statutory formal requirements for the 'promissory note', a convertible banknote appears to be truly a 'promissory note'; of course, this is provided it is convert-

<sup>247</sup> Above n 78.

<sup>248</sup> U.C.C. §3-104(a), (e).

<sup>249</sup> The various negotiable instruments covered by U.C.C. Article 3 are defined in §3-104.

<sup>250</sup> This predecessor was §3-103(1) of the previous Pre-Revised Version of the Official Text (U.C.C. §3-103(1) (1962 Version)).

<sup>251</sup> Defined in §3-104(e) as a 'promise', fulfilling requirements set out in §3-104(a), briefly stated, as to 'unconditional' language, sum certain, being payable either to bearer or order, and either on demand or at a definite time.

<sup>252</sup> The predecessor uniform law in the US covering negotiable instruments was the *Uniform Negotiable Instruments Law* (UNIL) (1896). See in general WE Britton, *Handbook of the Law of Bills and Notes*, 2nd edn (St. Paul, Minn: West, 1961) at 11. Its full text is reproduced in *ibid* at 708–25.

<sup>253</sup> *Bills of Exchange Act*, 1882 (UK), 45–46 Vict., c. 61 as amended (hereafter: BEA).

<sup>254</sup> A list of such jurisdictions appears in AW Rogers, *Falconbridge on Banking and Bills of Exchange*, 7th edn (Toronto: Canada Law Book, 1969) at 431–32 (hereafter: Rogers, *Falconbridge*). For a comprehensive list and exposition of variations, where applicable, see Ellinger, 'Negotiable Instruments', above n 246 at 46–54.

<sup>255</sup> See s 83(1), under which '[a] promissory note is an unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to, or to the order of, a specified person or to bearer.'

ible to, namely payable in, 'money'<sup>256</sup> rather than 'mere' precious metal or, in fact, anything else.<sup>257</sup> As well, usually, the inconvertibility of the banknote intended for circulation, particularly when it is issued by a central bank, is consistent with its being 'legal tender'; this function is however irrelevant for the characterization of the instrument under the *Bills of Exchange Act*. The focus in the ensuing discussion is thus on an inconvertible note<sup>258</sup> issued by a bank, usually a central bank, intended for circulation, which may or may not be legal tender.

In an earlier edition of Chalmers, a 'bank note' is defined as 'a promissory note issued by a banker payable to bearer on demand.'<sup>259</sup> Consistently, in the absence of a specific provision which addresses the characterization of the banknote as a 'promissory note', the prevailing view in England is that 'banknotes are promissory notes within the meaning of s. 83 of the Bills of Exchange Act 1882.'<sup>260</sup> Undoubtedly, this view must be taken to be cognizant of the fact that banknotes intended for circulation in England are nowadays inconvertible.<sup>261</sup> As will be seen below, the characterization of the banknote as a 'promissory note' holds true under English law even with regard to a foreign inconvertible banknote that is only denominated in a sum of money, but does not include an express payment obligation; in such a case, the payment promise on the banknote is said to be implicit.<sup>262</sup>

In Canada, the *Bills of Exchange Act*<sup>263</sup> is modelled on its English counterpart. Specifically, the definition it contains for a 'promissory note' is cast in the image of its English precedent.<sup>264</sup> As well, similarly to England, banknotes circulating as money in Canada are issued by the central bank, being the Bank of Canada,<sup>265</sup> and are inconvertible<sup>266</sup> as well as legal tender.<sup>267</sup> Unsurprisingly,

<sup>256</sup> Certainly this is so no matter how impractical (and difficult to achieve) convertibility becomes, as it was periodically in the US during the nineteenth century when 'demands by local note-holders' was treated as 'something like treason'. See eg B Hammond, *Banks and Politics in America: From the Revolution to the Civil War* (Princeton, NJ: Princeton University Press, 1957) at 691.

<sup>257</sup> A promissory note ought to be payable 'a sum certain in money'. See BEA s 83(1), reproduced above, n 255. A similar requirement appears in ULB art 75(2) and U.C.C. §3-104(a). Convertibility to foreign currency banknotes (see n 240 above) appears to me to be convertibility to money.

<sup>258</sup> Indeed, per text and notes immediately above, the discussion applies also to the banknote convertible to something other than 'money' itself.

<sup>259</sup> DAL Smout, *Chalmers on Bills of Exchange*, 13th edn (London: Stevens & Sons, 1964) at 274.

<sup>260</sup> Proctor, above n 165 at 25.

<sup>261</sup> For the demise of convertibility in England, see last paragraph of section 3.2 above.

<sup>262</sup> See below, discussion on *Banco de Portugal v Waterlow and Sons, Ltd*, text and nn 275–98.

<sup>263</sup> At present it is R.S.C. 1985, c. B-4.

<sup>264</sup> See the Canadian *Bills of Exchange Act* s 176, *ibid*.

<sup>265</sup> Under the *Bank of Canada Act*, S.C. 1934, c. 43, s 24(1), in principle, 'the sole right to issue notes payable to bearer on demand and intended for circulation in Canada' was vested in the Bank of Canada.

<sup>266</sup> Under the *Bank of Canada Act* s 25, *ibid*, banknotes were convertible to gold, except that the Governor in Council was authorized to suspend convertibility. Convertibility was abolished in 1966 (1966–67 (Can), c. 88, s 13), except that in fact it had never been practiced, since the Governor in Council passed every year an order-in-council suspending convertibility for that year. For a brief historical account, see *Bank of Canada v Bank of Montreal*, above n 233 at 1167 (S.C.R.).

<sup>267</sup> Under the *Bank of Canada Act* s 24(1), *ibid*.

during the period they were stated to be payable to bearer on demand, the original position followed that which prevailed in England. It was thus thought that:

[A] banknote, as regards its form and essential requirements, is simply the promissory note of a bank payable to bearer on demand, and its issue, transfer and discharge are governed by the provisions of the Bills of Exchange Act relating to a note payable to bearer on demand.<sup>268</sup>

Nonetheless, this proposition was not received well by courts in Canada. First, *Bank of Canada v Bank of Montreal*<sup>269</sup> challenged precedents supporting it<sup>270</sup> on the ground 'that the banknotes they dealt with were the notes of [commercial] banks, or were redeemable in gold or were not legal tender.'<sup>271</sup> As will be seen below, in the Supreme Court of Canada, the proposition was ultimately accepted, but not wholeheartedly, and not without a fight. Second, ultimately, the characterization of the banknote as a 'promissory note' was specifically rejected by legislation. Thus, Parliament eliminated in 1967 the promissory language with respect to Bank of Canada notes intended for circulation.<sup>272</sup> Thereafter, in 1980 another amendment was passed, explicitly stating that a banknote issued by the Bank of Canada is not an instrument governed by the *Bills of Exchange Act*.<sup>273</sup> This is the present section 25(6) of the *Bank of Canada Act*,<sup>274</sup> stating that '[n]otes of the Bank are neither promissory notes nor bills of exchange within the meaning of the *Bills of Exchange Act*.' The position in Canada is thus as under the *Uniform Commercial Code* in the United States.

<sup>268</sup> See eg Rogers, *Falconbridge*, above n 254 at 127.

<sup>269</sup> Above n 233.

<sup>270</sup> Such as *Suffell v Bank of England* (1882) 9 Q.B.D. 555; *Gillett v Bank of England* (1889) 6 T.L.R. 9 (Q.B.D.); *Raphael v Bank of England* (1855) 17 C.B. 161, 139 E.R. 1030; *Hong Kong and Shanghai Banking Corp v Lo Lee Shi* [1928] A.C. 181 (P.C.); *The Queen v Brown* (1854) 8 N.B.R. 13 (N.B.S.C.); and *Re Toronto Beaches Election, Ferguson v Murphy* (1943), [1944] 1 D.L.R. 204 (Ont. H.C.).

<sup>271</sup> Above n 233 at 403 (D.L.R.), 1175 (S.C.R.).

<sup>272</sup> *An Act to amend the Bank of Canada Act*, S.C. 1966–67, c. 88, s 12, amending the *Bank of Canada Act*, R.S.C. 1952, c. 13 (now R.S.C. 1985, c. B-2). The earlier provision (R.S.C. 1952, c. 13, s 21(1)) stated that '[o]n and after the day on which the Bank is authorized to commence business the Bank shall, except as provided in the Bank Act, have the sole right to issue notes payable to bearer on demand and intended for circulation in Canada and may, subject to Section 23, issue such notes to any amount; such notes shall be legal tender, and shall be the first charge upon the assets of the Bank.' S.C. 1953–54, c. 33, s 8, repealed this provision and substituted it with the following: 'The Bank has the sole right to issue notes payable to bearer on demand and intended for circulation in Canada and such notes shall be a first charge upon the assets of the Bank.' This was the statutory provision which governed *Bank of Canada v Bank of Montreal* above, n 233. Subsequently, the provision was repealed by S.C. 1966–67, c. 88, s 12, and replaced by the following: 'The Bank has the sole right to issue notes intended for circulation in Canada and those notes shall be a first charge on the assets of the Bank.' (Emphasis to the language of the 1952 and 1953 provisions is added.) In the 1967 provision there is no corresponding language to that emphasized in those of 1952 and 1953. Similarly, Bank of Canada notes 'payable to bearer on demand' and 'intended for circulation in Canada' were legal tender under the *Currency, Mint and Exchange Fund Act* of 1952, c. 315, s 7(1) (c). The 'payable bearer on demand' language was eliminated in the aforementioned *An Act to amend the Bank of Canada Act*, s 20(1)(c).

<sup>273</sup> *Banks and Banking Law Revision Act*, S.C. 1980–81–82–83, c. 40, s 49.

<sup>274</sup> *Bank of Canada Act*, R.S.C. 1985, c. B-2.



Objections to the characterization of the banknote as a 'promissory note' under the *Bills of Exchange Act*, in England and elsewhere where similar legislation exists, will now be examined. Examination is undertaken with regard to all such jurisdictions where they lack specific statutory provisions as in Canada. It will be carried out by reference to case law specifically dealing with inconvertible banknotes issued by a central bank which are legal tender.

Prior to *Bank of Canada v Bank of Montreal*, the legal nature of the banknote was a focal point for the discussion by the House of Lords in *Banco de Portugal v Waterlow and Sons, Ltd.*<sup>275</sup> The latter case involved a note that did not contain an explicit promise to pay.<sup>276</sup> It was an action by the Bank of Portugal against a firm of printers engaged by it to print a series of notes to be put into circulation in Portugal. Due to the printers' negligence, spurious notes<sup>277</sup> were put into circulation. The Bank of Portugal was forced to issue good notes in exchange for the spurious notes; any other course of action would have undermined public confidence in Portuguese paper currency.<sup>278</sup> The specific question to be determined was whether the Bank of Portugal was right in maintaining that the damage suffered by it was measured by the entire face value of the spurious notes.

In a three to two decision, the House of Lords held in the Bank of Portugal's favour. In determining the actual loss suffered by the Bank of Portugal, the Court had to assess the value of the Bank's engagement to the Bank itself. That is, the issue to be determined was the amount of loss suffered by the Bank by virtue of incurring liability on a banknote put into circulation. The judgments given reflect opposing views on the principal issue. Nevertheless, they seem to generate consensus as to the nature of the banknote in its holder's hands.

The majority judgments<sup>279</sup> were premised on the nature of the banknote as not merely a piece of paper. Rather, emphasis was put on the fact that banknotes circulate on the basis of the creditworthiness of their issuer. Such creditworthiness is maintained by public law restrictions designed to adjust their quantity to actual resources. In the normal course of events, nobody will receive from the issuing bank a banknote, except for valuable consideration.

Viscount Sankey LC thought that, irrespective of inconvertibility, 'a bank of issue receives value for every note which it issues.' This is so since in connection with 'a managed currency' there is no 'unlimited right to issue notes.'<sup>280</sup> Lord Atkin was of a similar opinion: 'In any civilized State [the central bank] will not be permitted to issue notes to an unlimited amount.' Obligations embodied in

<sup>275</sup> [1932] A.C. 452 (H.L.).

<sup>276</sup> The promise was read into the note anyway. *Ibid* at 487, per Lord Atkin.

<sup>277</sup> In general, a valid banknote is legitimately made from a genuine plate and bears genuine signatures of issuing officers. A banknote which either bears a forged signature or is not a legitimate impression from a genuine plate is spurious. See *Black's Law Dictionary*, above n 134 at 166 (v. 'banknote').

<sup>278</sup> Above n 275 at 471, per Viscount Sankey LC.

<sup>279</sup> The majority consisted of Viscount Sankey LC, Lord Atkin, and Lord MacMillan.

<sup>280</sup> Above n 275 at 477.

paper money must correspond to possible resources: 'the State will require that behind the promises to pay there stand solid resources in the form of gold and liquid securities.' Accordingly, it 'will impose a positive restriction on the issue of notes beyond an amount which it considers necessary.'<sup>281</sup> This is true where the note is payable in gold, and 'has not [been] altered' by inconvertibility, except that, thereunder, the Bank's liability is to pay with its own notes on other legal tender, and not gold.<sup>282</sup> In the final analysis, by issuing its notes, the Bank, like a trader who issues a promise to pay a fixed sum, 'issues a bit of its credit to that amount.'<sup>283</sup>

The majority's conclusion is stated by Lord MacMillan:<sup>284</sup>

[T]he Bank, being compelled to issue for nothing notes for which if it had issued them in ordinary course it would have received value corresponding to the purchasing power of the number of [monetary units] which they represented, has suffered loss to the extent of the face value of these notes.

On the other hand, the dissenting law lords<sup>285</sup> focussed on the fact that the issuing bank's power to put paper money to circulation was unattached to specific gold reserves or collateral securities. Lord Warrington thought that, on every banknote, 'the obligation incurred by the Bank is merely to pay in other currency which it has power to create.' Accordingly, where the Bank elects to issue good notes in substitution of circulating spurious notes, 'all it has to do is to take so many pieces of printed paper from its existing stock or to have further notes created should the existing stock be insufficient.' Under such circumstances, '[i]n either case, the loss to the Bank is . . . confined to the expense of procuring the necessary paper and of printing the necessary number of notes.'<sup>286</sup> Lord Russel spoke of a 'windfall for the Bank' by the majority decision since no actual loss had been proven.<sup>287</sup>

The extremity of both positions was severely criticized. A more sensitive valuation of damages might have been called for.<sup>288</sup> Such valuation ought to have recognized that the gain to the holder to whom a replacement note is issued is not the same as the loss to the issuing bank. Indeed, for the former the gain is the face value of the instrument; for the latter, the loss is the result of the reduction in the amount of its future permissible issue,<sup>289</sup> as a matter of implementing

<sup>281</sup> *Ibid* at 487.

<sup>282</sup> *Ibid* at 488.

<sup>283</sup> *Ibid* at 489.

<sup>284</sup> *Ibid* at 511.

<sup>285</sup> These were Lord Warrington of Clyffe and Lord Russel of Killowen.

<sup>286</sup> Above n 275 at 484.

<sup>287</sup> *Ibid* at 502.

<sup>288</sup> For an extensive critical discussion see eg A Nussbaum, *Money in the Law National and International: A Comparative Study in the Borderline of Law and Economics* (Brooklyn: Foundation Press, 1950) at 84–89, and sources cited there. See also J Tillotson, 'The Portuguese Bank Note Case: Legal, Economic and Financial Approaches to the Measure of Damages in Contract' (1994), 68 *Australian Law Journal* 93. For a favourable analysis, see Proctor, above n 165 at 29–31.

<sup>289</sup> Nussbaum, *ibid*.

its monetary policy,<sup>290</sup> for which it potentially stood to make a modest profit. 'Hence, the inconvertible note in the hands of the bank has a potential value which is far below that of a circulating note and difficult to formulate in exact figures.'<sup>291</sup> However, both parties navigated the litigation so as to avoid a middle course. This did not escape the attention of two law lords. Thus, in his dissent, Lord Russell explicitly stated that '[t]he Bank [made] no claim based on curtailment of their powers of issue'.<sup>292</sup> Thus, in the absence of an argument on the curtailment of the Bank's powers of issue, the dissent assessed the loss to the Bank to be limited to printing and other incidental expenditure incurred by it upon the issue of replacement notes. For his part, speaking for the majority, Lord MacMillan lamented that the parties presented a choice between two extremes, with no middle course.<sup>293</sup> This limited choice might have pushed the majority to focus on the gain to the holder as the proper basis for assessing damages.

Much of the discussion was around the nature of the banknote as a promissory note. In his concurring majority judgment, Lord MacMillan understood the dissenting position to be that '[a] promissory note which is perpetually renewable has theoretically no value, because it is never payable.'<sup>294</sup> He rejected this view altogether. Nevertheless, his theory on the nature of the banknote, which purported to refute the dissent, seems to reflect a universal consensus, not rejected at all by the dissent, on the nature of the holder's right on a banknote. Thus, 'quite irrespective of convertibility',

a note when issued by the Bank of Portugal becomes by the mere fact of its issue legal tender for the sum which it bears on its face. The issued note represents so much purchasing power in terms of commodities. It can be used by the holder of it to purchase at current prices any commodity in the market, including gold and securities. It can equally be used by the Bank to purchase commodities, including gold and securities, or to discharge debts due by it. It must be accepted by the Bank in discharge of debts due to it.<sup>295</sup>

In fact, there was no disagreement among the law lords as to the nature of the issuing bank's engagement to the holder of a banknote in circulation. Speaking for the majority, Lord Atkin stated that, even without an express promise to pay stated in it, '[a] bank note is a promissory note issued by a bank payable on demand', so as anyway to be read as if it contains a promise to pay.<sup>296</sup> This was also the opinion of the dissenting Lord Warrington, who regarded issued

<sup>290</sup> Banknotes held by the public are part of the money supply, regulated by the central bank of the relevant country. Usually, compared to 'commercial-bank money', the number of banknotes and coins in circulation is small and thus, for simplicity, the number of banknotes (and coins) in circulation was overlooked in the analysis of monetary policy in section 3.4 above.

<sup>291</sup> Nussbaum, above n 288 at 86.

<sup>292</sup> Above n 275 at 501.

<sup>293</sup> *Ibid* at 507.

<sup>294</sup> *Ibid* at 508.

<sup>295</sup> *Ibid*.

<sup>296</sup> *Ibid* at 487.

banknotes as 'promissory notes payable to bearer on demand.'<sup>297</sup> Both agreed that payment by the issuing bank may be made in other banknotes, in gold if convertibility was to be resumed, or in other currency if so decreed.<sup>298</sup>

No similar consensus on the characterization of the inconvertible banknote emerged from the subsequent decision of the Supreme Court of Canada in *Bank of Canada v Bank of Montreal*.<sup>299</sup> Rather, in that case, views varied as to the nature of the issuer's engagement and the holder's right on it. In connection with a fact situation occurring in 1959, the case dealt with a Bank of Canada note in its pre-1967 form, that is, a legal tender inconvertible banknote, expressly stated to be payable to bearer on demand, not yet excluded from the scope of the Canadian *Bills of Exchange Act*.<sup>300</sup>

The specific question dealt with in that case was whether the ex-holder of a Bank of Canada banknote destroyed by fire is entitled to obtain from the Bank of Canada a substitute banknote.<sup>301</sup> Indeed, by issuing a note in replacement, the issuing bank suffers no loss since, in theory, the destroyed note is deleted from the liabilities on its balance sheet, and the new note is printed under existing powers.<sup>302</sup> Perhaps as a matter of policy, the main issue is whether a central bank should be burdened with the duty to scrutinize claims for destroyed notes.<sup>303</sup> In any event, the question was determined primarily not on its own merit, but rather as a derivative of a broader question, as to the characterization of a banknote. Thus, in the absence of specific provisions relating to destroyed banknotes, the principal issue was the application of the provisions in the *Bills of Exchange Act* governing lost instruments. To fall under these provisions, the banknote must be a 'promissory note' governed by the *Bills of Exchange Act*.<sup>304</sup>

In the Ontario Court of Appeal,<sup>305</sup> Brooke JA discussed the effect of the promissory language contained in the banknote. Taking into account inconvertibility to gold, he nevertheless held that 'payment [of Bank of Canada notes] can be made in legal tender of money',<sup>306</sup> that is, in coins or other banknotes.<sup>307</sup> Indeed, he acknowledged that a Bank of Canada note 'has the additional characteristics of being a note intended for circulation . . . and of being legal tender

<sup>297</sup> *Ibid* at 483.

<sup>298</sup> *Ibid* at 483–84, per Lord Warrington; and at 488–89, per Lord Atkin.

<sup>299</sup> Above n 233.

<sup>300</sup> See nn 265–66 and text around them.

<sup>301</sup> Relevant provisions of the Canadian *Bills of Exchange Act* cited in the case were ss 10, 156, 157 and 176 (R.S.C. 1970, c. B-5). They are now ss 9, 155, 156 and 176 (R.S.C. 1985, c. B-4). They correspond to the English BEA ss 97(2), 69, 70 and 83.

<sup>302</sup> FA Mann, 'The Destroyed Banknote' (1977–78), 2 *Canadian Business Law Journal* 471.

<sup>303</sup> See Nussbaum, above n 288 at 82–83.

<sup>304</sup> The relevant provisions are ss 69–70 (England) and 155–156 (then 156–157 of R.S.C. 1970, c. B-5, as amended) (Canada). See n 301 above. These provisions apply to promissory notes (and not only to bills of exchange) by virtue of s 89(1) in England and s 186(1) in Canada.

<sup>305</sup> *Sub nom Bank of Montreal v Bay Bus Terminal (North Bay) Ltd* (1972) 30 D.L.R. (3d) 24 (Ont C.A.).

<sup>306</sup> *Ibid* at para 12.

<sup>307</sup> This is 'pursuant to the provisions of s. 7 of the Currency, Mint and Exchange Fund Act [above n 272]', *ibid*. Presently *Currency Act*, R.S.C. 1985, c. C-52, s 8.

or money.<sup>308</sup> However, he preferred to stay in line with previous judicial and scholarly authority.<sup>309</sup> He thus held that notwithstanding such 'special characteristics', the Bank of Canada note 'is nevertheless essentially a promissory note within the meaning of the definition in the Bills of Exchange Act'.<sup>310</sup>

A panel of the Supreme Court of Canada was evenly divided. Thus, in not dismissing the appeal, it affirmed it, albeit by default.<sup>311</sup> Supporting the conclusion of Brooke JA, Beetz J stressed that 'with respect to negotiable instruments, form prevails over substance.' Hence, the fact that 'Parliament has decreed by statute that the notes of the Bank of Canada be in the form of promissory notes as defined by . . . the *Bills of Exchange Act* cannot be ignored'.<sup>312</sup> On this basis, as well as on authority,<sup>313</sup> he had 'no hesitation in agreeing . . . that the . . . bank-note under consideration is a promissory note'.<sup>314</sup>

A powerful dissent was given by Laskin CJC, who gave particular weight to the public nature of the statutory scheme governing the Bank of Canada notes in contrast with the private nature of the instruments governed by the *Bills of Exchange Act*. In his opinion, a contention premised on literal interpretation and application of the *Bills of Exchange Act* overlooked this contrast.<sup>315</sup>

Laskin CJC could not assign a great degree of importance to the promissory language contained in the Bank of Canada note. In his view, 'the statutory declaration that the notes are legal tender, added to the fact that they have no convertibility into gold or anything else, is a more persuasive indication of their character than the inscription on [the notes] that they are payable to bearer on demand'.<sup>316</sup> Thus:

What is said to be an unconditional promise to pay a sum certain in money is itself money. The words on the face of the paper money, 'will pay to the bearer on demand', cannot alter its character as money and turn it into a different document which calls for the payment of money.<sup>317</sup>

In contrast, 'a promissory note, by definition, involves an unconditional promise to pay a sum certain in money, but it is not itself money'.<sup>318</sup> Thus, he stated that the promissory note and the banknote are quite distinguishable:

<sup>308</sup> *Bay Bus Terminal*, *ibid* at para 7.

<sup>309</sup> Authority is set out in the judgment, *ibid* at paras 8–9.

<sup>310</sup> *Ibid* at 28.

<sup>311</sup> *Bank of Canada v Bank of Montreal*, above n 233. The judgment siding with the Court of Appeal was delivered by Beetz J, with whom Ritchie, Pigeon and De Grandpré JJ concurred. The dissenting judgment was of Laskin CJC, with whom Martland, Judson and Dickson JJ concurred. In a 4 to 4 decision, the appeal was dismissed.

<sup>312</sup> *Ibid* at 1169 (S.C.R.), 399 (D.L.R.).

<sup>313</sup> Set out in *ibid* at 1170–76 (S.C.R.), 401–03 (D.L.R.).

<sup>314</sup> *Ibid* at 1176 (S.C.R.), 404 (D.L.R.). Responding to the attempt to distinguish old authorities (cited in n 270 above) Beetz J stressed that many of the leading textbooks and treatises considering notes of central banks as promissory notes 'have been published or re-edited after the abandonment of convertibility and while such notes were legal tender.' *Ibid* at 1176 (S.C.R.), 403 (D.L.R.).

<sup>315</sup> *Ibid* at 1152–56 (S.C.R.), 387 (D.L.R.).

<sup>316</sup> *Ibid* at 1156 (S.C.R.), 389 (D.L.R.).

<sup>317</sup> *Ibid* at 1154 (S.C.R.), 388 (D.L.R.).

<sup>318</sup> *Ibid* at 1156 (S.C.R.), 389 (D.L.R.).

True, the obligation of a promissory note may be carried forward by a renewal note, but no matter how many renewals there be, or how many replacements under different terms, there is no liquidation of the debt until it is discharged, and this may be by money or money's worth or the debt may be forgiven. To say that a banknote of the kind involved here imports similar legal consequences, that a non-convertible bank note is paid off by the giving of a bank note of similar face value is to go around in a circle: legal tender is exchanged for legal tender; a different piece of paper, true, but indistinguishable in legal effect from the one surrendered for it.<sup>319</sup>

Regarding the promise contained in the Bank of Canada note as 'sterile from the very beginning',<sup>320</sup> he found *Banco de Portugal v Waterlow & Sons, Ltd*<sup>321</sup> to be 'completely unpersuasive on the point in issue.'<sup>322</sup> In his view, inasmuch as the liability on an inconvertible banknote can be satisfied by the tender of another banknote of the same nature and value, such liability is 'unreal' and basically unenforceable:

[A]ny holder who would sue in such a situation must surely have his claim rejected . . . and be required to pay costs, if not also to be told that he is engaged in a vexatious proceeding.<sup>323</sup>

Finally, Laskin CJC dismissed the reliance placed on the balance sheet treatment of banknotes by the Bank of Canada. As required by statute, banknotes appear on the liability side of the balance sheet and are 'first charge upon the assets of the Bank.'<sup>324</sup> Nevertheless, in his view, 'a promissory note is not in any sense a charge upon the assets of the maker.'<sup>325</sup> Furthermore, inasmuch as most assets of a central bank are government debts, realization is impossible.<sup>326</sup>

<sup>319</sup> *Ibid* at 1156 (S.C.R.), 389–90 (D.L.R.).

<sup>320</sup> *Ibid* at 1157 (S.C.R.), 390 (D.L.R.).

<sup>321</sup> Above n 275. See text around nn 275–98 above.

<sup>322</sup> Above n 233 at 1157 (S.C.R.), 390 (D.L.R.).

<sup>323</sup> *Ibid* at 1158 (S.C.R.), 391 (D.L.R.).

<sup>324</sup> *Bank of Canada Act* s 21(1), above n 272 (now *Bank of Canada Act* s 25(1), above n 274).

<sup>325</sup> Above n 233, at 1159 (S.C.R.), 392 (D.L.R.). On that point, Laskin CJC may have gone too far, at least for a promissory note in general, as a matter of private law. Arguably, the theory of the *Bank of Canada Act*, s 25(1) is that the Bank's indebtedness on banknotes is secured by way of first charge on the assets of the Bank. This can indeed be quite consistent with indebtedness on a promissory note as well. However, Laskin CJC appears to be correct as to the banknote. Thus, according to Nussbaum, above n 288 at 79–80, the production of issued banknotes on the liability side of the balance sheet of a central bank is 'for reasons of accounting.' Furthermore, reserve requirements ought to be construed as public law instruments and 'are ordinarily not generators of private rights.' *Ibid*.

<sup>326</sup> *Bank of Montreal, ibid* at 1160 (S.C.R.), 392 (D.L.R.). According to the most recent statutory standard form, being Schedule II of R.S.C. 1985, c. B-2, as rep. by S.C. 2001, c.9, s 202, assets of the Bank of Canada fall into six categories: (1) gold coin and bullion; (2) deposits payable in foreign currency; (3) advances to the Government of Canada, to Provincial Governments, and to members of the Canadian Payments Association (depository financial institutions); (4) investments in Treasury Bills of Canada, other securities issued or guaranteed by Canada or a province, bonds and debentures issued by the Industrial Development Bank and other bills and investments; (5) Bank premises; and (6) all other assets. In practice, '[t]he Bank of Canada does not maintain reserves of gold in its own right, and an examination of its balance sheet reveals that its assets are comprised mainly of federal Government securities.' See G David, 'Money in Canadian Law' (1986), 65 *Canadian Bar Review* 192 at 199.

In fact it is even expressly unpermitted, or at least severely restricted, by statute.<sup>327</sup>

Under those circumstances, he rejected the submission that 'the pre-1967 notes of the Bank of Canada fall within the definition of a promissory note under s. 176(1) of the *Bills of Exchange Act*.'<sup>328</sup>

Ultimately, having failed to reach a decision, the Supreme Court affirmed, albeit by default, the judgment of the Court of Appeal.<sup>329</sup> The view that the banknote is a promissory note thus narrowly prevailed. However, Laskin CJC's dissent proved to be too well-reasoned to be ignored. Indeed, by the time the Supreme Court gave its decision in *Bank of Canada v Bank of Montreal*, Parliament had already eliminated, in 1967, the promissory language from the banknote.<sup>330</sup> Yet, it may have been recognized that due to *Banco de Portugal v Waterlow and Sons, Ltd*,<sup>331</sup> even the deletion of the promissory language from the post-1967 banknotes in Canada could not ensure that Laskin CJC's view would be adopted with regard to the new form.<sup>332</sup> Parliament thus intervened. Effectively following Laskin CJC's view, Parliament provided in 1980 that Bank of Canada notes are not promissory notes under the *Bills of Exchange Act*.<sup>333</sup>

This created a rift between England and Canada as to the characterization of the banknote. The question which arises is whether Laskin CJC's position, as in fact adopted by the legislature, is convincing. Another aspect of the same question is whether retaining the characterization of banknotes as promissory notes is justified as a matter of principle.

There are two basic flaws in Laskin CJC's position. First, he overlooked the history of the banknote as the forerunner of the modern promissory note.<sup>334</sup> Second, there is nothing conceptually wrong in viewing a particular type of a promissory note, such as the banknote, as money, as long as such a promissory note is treated as money even though it contains a promise to pay money. At the same time, the contrary view failed to respond to Laskin CJC's two main points. The first refers to the existence of a comprehensive statutory scheme governing banknotes issued by a central bank so that a negative implication as to the application of the *Bills of Exchange Act* may be inferred. The second point is the inconvertibility of the banknote to the point of rendering the payment promise into an empty formula, quite 'sterile' and 'unreal'.

<sup>327</sup> Under the *Bank of Canada Act* the liquidation of the Bank of Canada requires specific legislation and is exempted from the coverage of general insolvency or winding-up statutes. Originally this was provided for in S.C. 1934, c. 43, s 41. Presently it is provided for in R.S.C. 1985, c. B-2, s 34 (R.S.C. 1970, c. B-2, s 30 at the time of the judgment).

<sup>328</sup> Above n 233 at 1153 (S.C.R.), 388 (D.L.R.).

<sup>329</sup> See text at nn 305–10 above.

<sup>330</sup> See text and n 272 above.

<sup>331</sup> Above n 275.

<sup>332</sup> For that position in *Banco de Portugal v Waterlow and Sons, Ltd* (with regard to the Portuguese banknotes) see text and nn 296–98 above.

<sup>333</sup> S.C. 1980–81–82–83, c. 40 Part III, s 49 (presently R.S.C. 1985, c. B-2, s 25(6)) discussed in text at nn 272–74 above.

<sup>334</sup> See in general ch 11, section 3 below.



As will be discussed below in chapter eleven, section 6, historically, the ‘currency’ of coin underlay the ‘negotiability’ of the banknote. Both concepts preceded the *Bills of Exchange Act*<sup>335</sup> and can exist independently of it.<sup>336</sup> Arguably, the denomination on a coin is a binding representation by its issuer as to its purchasing power. The same can be said of the banknote. Hence, the promissory language is no longer a required, nor is it a distinctive, element of the banknote. Its characterization as a promissory note is merely reminiscent of its historical development. Indeed, way back in 1758, Lord Mansfield spoke of Bank of England notes as being ‘*treated* as money, as cash, in the ordinary course and transaction of business’ (emphasis added);<sup>337</sup> yet, he immediately continued and said that ‘they *are* as much money, as guineas themselves are; or any other current coin, that is used in common payments, as money or cash’ (emphasis added).<sup>338</sup> Certainly today, Bank of England notes are even more ‘money’ than any current coin. Undoubtedly, the character of banknotes as ‘money’ has come to overshadow their qualities as ‘promissory notes’ so as, possibly, to supersede such qualities altogether. Indeed, it is quite likely that points relating to the juridical nature of the banknote and not explicitly provided for by banknotes legislation may well be decided by analogy to principles governing promissory notes and now codified in the *Bills of Exchange Act*. At the same time, there may be compelling policy reasons to avoid the automatic application of the *Bills of Exchange Act* to the banknote in a wholesale fashion. Thus, on balance, Laskin CJ’s position appears to me to be more persuasive than that of his adversaries.

##### 5. GOLD REDUCED TO PAPER AND ENTRIES TO ACCOUNTS: METALLISM, NOMINALISM, PAPER MONEY AND BANK MONEY

In a development stretching from the ancient era to modern days, physical objects that constitute money have continuously evolved and transformed. Throughout each stage, money took a distinct form as follows:

1. Metal or other chattel (‘primitive money’ in the ancient world).
2. Coin with metallic content of value approved or certified by the State (coined money in the ancient world).
3. Metallic token on which higher metallic value is conferred by the State (coined money in medieval Europe as recognized in the *Case de Mixt Moneys* (1605)).<sup>339</sup>

<sup>335</sup> The leading case is *Miller v Race* (1758), above n 128, discussed further below in ch 11, section 6 below.

<sup>336</sup> From this perspective, the view that ‘coins may be described as “negotiable chattels”’ (Holden, above n 13 at 259–60) may be tainted with anachronism, as it may erroneously be understood to imply that ‘negotiability’ *encompasses* the coin, while in fact ‘negotiability’ was *heralded* by the ‘currency’ qualities of the coin.

<sup>337</sup> *Miller v Race* (1758), above n 128 at 457 (Burr), 401 (E.R.).

<sup>338</sup> *Ibid.*

<sup>339</sup> Davis 18, 80 E.R. 507.

4. Paper fully backed by and convertible to metal (the goldsmith's note and, at various stages, the Bank of England note).
5. Paper unbacked by, but convertible to, metal (the Bank of England note, to some extent originally and under the fiduciary note issue since 1877).
6. Paper unbacked by, and inconvertible to, metal, but containing a promise to pay (paper money in England at least since 1931).
7. Paper unbacked by, and inconvertible to, metal, and not containing an express payment promise (paper money in Canada since 1967).<sup>340</sup>

This brings up several major distinctions. First, there is the distinction between 'primitive money' and money. Second, a distinction exists between the coin ('metallic money') and the banknote ('paper money'). Third, the coin may be either of a metallic value as it truly exhibits, or a mere token of a lower metallic value. Fourth, paper money may be either convertible or inconvertible. Fifth, paper money either may or may not be backed by metal. Sixth, inconvertible paper money may or may not contain an express promise to pay. In addition, as explained below, there is a distinction between 'metallism' and 'nominalism'.

Depending for its acceptance upon its issuer's creditworthiness and not upon a valuable substance contained in it, the banknote is akin to 'credit currency'.<sup>341</sup> Nevertheless, it does not follow that paper money is necessarily inconvertible, unbacked by metallic reserves, or associated solely with nominalism. Indeed, the banknote can either be convertible or inconvertible, as well as either backed or unbacked by metal. Notwithstanding observations to the contrary,<sup>342</sup> convertibility, backing, and metallism are not interchangeable.

The distinction between metallism and nominalism turns on the standard of value set by the money in question.<sup>343</sup> Thus, as a medium of exchange, money is expressed by reference to a unit of account which constitutes a common denominator of value. Such a unit reflects the purchasing power of either a specified quantity of metal ('metallism') or an abstract unit of measurement disassociated from the metallic standard ('nominalism').<sup>344</sup> A payment obligation is 'a contract to pay so many standard units of value by tendering coins or [bank]

<sup>340</sup> The first three stages are discussed in ch 2 above. The last four stages are discussed earlier in this chapter.

<sup>341</sup> According to Feavearyear, above n 33 at 99, '[c]redit currency depends for its acceptance, not upon containing within itself a substance with a value apart from its value as money, but upon people's belief that a promise to exchange it for other money will be honoured.' See text and n 56 above.

<sup>342</sup> See eg *Banco de Portugal v Waterlow and Sons, Ltd*, above n 275, where Lord MacMillan explains (at 509) the difference between a convertible and inconvertible note as follows: 'A bank of issue which undertakes to pay its notes in gold undertakes to give in exchange for them a commodity of universally recognized value, and therefore a paper currency backed by gold possesses a high value in exchange; it is in effect as good as gold. On the other hand a paper currency which the bank issuing it does not undertake to pay in gold has necessarily a lower value in exchange; its purchasing power is not measurable in terms of a universally accepted standard, but depends on the credit of the issuing bank.'

<sup>343</sup> The distinction was addressed in ch 2, particularly in sections 2 and 3.

<sup>344</sup> The 'nominalistic principle' is defined by Proctor, above n 165 at 228 and is thoroughly discussed by him in ensuing pages. For the 'nominalistic doctrine' see Nussbaum, above n 288 at 17.

notes . . . for the amount.<sup>345</sup> What constitutes the unit of account is thus determined according to whether the pertinent standard of the money in question is that of metallism or nominalism. Throughout the various above-mentioned stages of the development of money, transformation from metallism to nominalism has taken place. However, as demonstrated in the discussion that follows, metallism may survive in a paper environment, and even co-exist with inconvertibility, as long as metallic backing is pursued.

As it is presently conceptualized, in the context of the evolution set out at the beginning of this section, money emerged in the course of the second stage, that is, as a coin with a metallic content of value approved or certified by its issuer. At that point, the purchasing power was certified in terms of the value of the metallic content of the coin. Stated otherwise, 'exchange value' was equal to 'use value'. This was the highest point of 'metallism'.

Nonetheless, even as equal to 'use value', 'exchange value' reflects a distinct concept of value. The point did not escape Aristotle's attention. Thus, in acknowledging that 'money is subject to the vagaries of the market just like other commodities,' and yet 'its purchasing power . . . is pretty constant',<sup>346</sup> Aristotle effectively focused on money as a chattel carrying a quantified amount of purchasing power rather than having its own use value. Thereby, he highlighted the concept of value as a unit of account in which prices are denominated.<sup>347</sup>

Perhaps the distinction between the two concepts of value can best be demonstrated by reference to a hypothetical example of a healthy ox, used in agriculture, as well as a medium of exchange. The discussion relating to that hypothetical example will of course eliminate 'practical' considerations such as storage and maintenance. Thus, in that system, an ox certified healthy has *prima facie* the same value for a farmer and for a party who receives it solely as a medium of exchange. However, the farmer alone is concerned with the soundness or good health of the ox. The party who receives the ox as a medium of exchange would not be concerned with the true health of the ox, as long as potential payees would accept that particular ox as healthy. Acceptance of the ox in payment as healthy would turn not on whether the ox is really healthy, but rather on the soundness or creditworthiness of the 'stamp of approval' given to the ox as healthy. Stated otherwise, as long as potential payees are confident that the certifying authority will give a healthy ox in return for the ox certified as healthy, the certification has the value of a truly healthy ox. That is, the 'exchange value' is actually the value of the certification and not the 'use value'. Therefore, a distinct 'exchange value' is associated with the second stage in the development of money. Prior to the certification, that is, in the earlier stage of

<sup>345</sup> *Broken Hill Proprietary Company, Ltd v Latham* [1933] 1 Ch. 373 at 408 (C.A.) per Romen LJ (C.A.).

<sup>346</sup> JAK Thomson, trans, *The Ethics of Aristotle* (Harmondsworth; NY: Penguin Classics, 1955) at 153–54. See ch 1, section 2, n 7 above.

<sup>347</sup> However, this may fall short of a pronouncement of the nominalistic principle as set out according to Proctor, above n 165 at 228, and focusing on a quantity of abstract units of value.

‘primitive money’, there were no grounds for a conceptual distinction between the two types of value.

Indeed, in a pure ‘metallistic’ environment, ‘exchange value’ and ‘use value’ happen to be equal. This is true whether the certified object is an ox or a metallic piece. For that reason, a coin of a genuine metallic value is not akin to ‘credit currency’,<sup>348</sup> notwithstanding the distinct value of the certification.

The equation between ‘exchange value’ and ‘use value’ breaks down where the certifying authority manipulates the distinct concept of value attached to its certification. Thus, the certifying authority may confer on a coin an ‘exchange value’ which exceeds the value of its metallic content. This occurred in the third stage of the development of money. This is the point where ‘nominalism’ replaces ‘metallism’.

Along these lines, it is correctly concluded that the *Case de Mixt Moneys*<sup>349</sup> is ‘a clear authority for the application of the nominalistic principle.’<sup>350</sup> Nevertheless, the case does not mark the end of metallism in England. A distinction ought to be made between the recognition of nominalism by that case and the ensuing history of money. In fact, elements of metallism persisted in England until inconvertibility.

Thus, throughout the fourth and fifth stages, English coined money continued to be of genuine metallic content. Indeed, paper money is not inconsistent with metallism. In principle, as long as each banknote is fully backed by metal, whether as full-body coin or specie, metallism remains the prevailing standard.

The issue of banknotes unbacked by metal (the fifth stage) may have signalled the fall of metallism. Nevertheless, prior to inconvertibility, that is, as long as the system was premised on the holder’s right to obtain metal upon the presentment of the banknote, no genuine nominalism seems to have emerged. To that end, whether convertible unbacked paper reflects nominalism or metallism depends on what, as between convertibility or backing, determines this question.

Pure nominalism was introduced in England in the course of the sixth stage, that is, with the elimination of convertibility in addition to that of metallic backing. The ultimate (seventh) stage of deleting the express promissory language from the banknote took place in Canada and, so far as the nature of the banknote as paper money is concerned, was merely a symbolic acknowledgement of the complications that arose at the conclusion of the inconvertibility stage.

At its inception, the banknote was a payment mechanism. In its evolution into paper money, it underwent five distinct stages:

- (1) The acceptance of the banknote, first the goldsmith’s note and then the Bank of England note, as a universal medium of exchange. At some point along that process of gradual acceptance, the banknote became money.

<sup>348</sup> As defined in n 341 above and text around it.

<sup>349</sup> Above n 339. The case is discussed at length in ch 2, section 3 above.

<sup>350</sup> Proctor, above n 165 at 237.

- (2) The pronouncement of the Bank of England note as legal tender. This firmed the process of acceptance.
- (3) The fiduciary note issue. This confirmed the nature of paper money as dependent on the issuer's creditworthiness rather than on the security of gold reserves or other collateral backing it.
- (4) Inconvertibility. This carried the implication of the previous stage even further. Inasmuch as the fiduciary note issue had reflected dependence on mere creditworthiness, payment in specie became redundant.
- (5) Omitting the express promise to pay from the banknote forms. This was a mere formality, occurring in Canada but not in England, acknowledging the implications of the previous stage.

In a sense, the evolution of the banknote from a payment mechanism to paper money defeated the original purpose of the instrument. From a machinery designed to facilitate the transfer of funds without the need to carry money in specie, the banknote turned into a specie of money, the possession of which was subject to risks of theft and loss. Nevertheless, the mercantile community had benefited from paper money in its early stages. First, paper money weighed less and required less space than metallic money. Thus, compared to metallic money, it was easier and cheaper to carry and store paper money. Second, inasmuch as paper money was made of valueless material, its physical destruction was not always tantamount to absolute loss. Under some circumstances, its issuer might replace damaged paper.<sup>351</sup> From the issuer's viewpoint, inasmuch as the evolution of paper money coincided with the early development of banking, the issuance of banknotes to a depositor did not require the issuer to keep the deposited coins. An increase in deposits, due to the growing acceptability of the paper issued in respect of them, gave the banker more money to create loans, which resulted in a higher volume of business that benefited society as a whole.

It was, nevertheless, the next logical step that was crucial to the development of paper money. If the deposited coins, against which banknotes were issued, did not have to stay with the banker, why did they have to be there in the first place? Paper money became acceptable on the basis of the creditworthiness of its issuer, rather than on the basis of actual coins deposited with the issuer. Hence, paper money could be issued by a creditworthy issuer irrespective of lack of actual coins in the issuer's hands.

This latter characteristic ultimately attracted the Government to the business of note issuing. Banknotes could be printed against the credit of an institution backed, set up, or nationalized by the Government, with no requirement that

<sup>351</sup> Provided tangible verifiable evidence of any damaged money is presented. Thus, eg 'Canadians can cook, mangle, bury and even burn their money, and as long as the Bank of Canada can find some way to authenticate the bills, the money will be redeemed at full value' (B Yaffe, 'Mangled and Burnt Cash Still Redeemable if Recognized' *The [Toronto] Globe & Mail* (31 July 1985) 4). Whether statutory provisions relating to the loss of promissory notes apply to the destruction of a banknote is a disputed question, discussed in *Bank of Canada v Bank of Montreal*, above n 233, discussed in section 4 above.

actual coins be deposited with it. These banknotes, issued by a governmental body, and either implicitly or explicitly backed by the Government itself, were soon to be conceived and sanctioned as legal tender. Issuance of such paper money became a powerful tool in shaping governmental policies.<sup>352</sup>

In different periods, scarcity of metallic money led to debasement, evolution of payment mechanisms, and the emergence of paper money. Money became a chattel whose purchasing power was dependent on the value conferred upon it by the State irrespective of its intrinsic value. Paper money was the culmination of this process. However, with the development of the banking system, and particularly the advent of electronic banking, the banknote has been losing its seniority as money; rather, it is 'commercial-bank money' that has been rising to take its place.

As seen in chapter two above, in Antiquity and throughout the Middle Ages, money consisted of coins. However, per the discussion in chapters three and eight, originally in Antiquity and to a larger extent, in the Middle Ages and beyond, deposit banking gave rise to payments between bank accounts. Here lie the roots of 'bank money', in the form of credit to an account held with a banker, and used as 'scriptural money' in payment of debts, operating by debiting one account and crediting another. In fact, 'bank money' preceded the banknote. It is the expansion of the banking system and the advent of 'commercial-bank money', as discussed above in section 3 of this chapter, that brought 'bank money' to the forefront. As discussed below, being 'monetary value', 'bank money' was not immediately identified as money, particularly as it had not been backed by the State. However, the categorization of the goldsmith note as 'money' on one hand and, subsequently, with the diminishing expectations of parties to actually convert 'bank money' to specie on the other hand, both reinforced the position of 'bank money' as 'money'.

Thus, in the footsteps of the discussion in chapter one above, 'bank money' used in payment is monetary value transmitted by means of a payment mechanism. Stated otherwise, 'bank money' serves as money only as long as it is convertible to money, that is, coins and banknotes. However, except for low-value face-to-face transactions, this conversion is seldom sought; typically, the quantity of cash available in bank vaults does not even purport to meet but a small fraction of the greater demand for non-cash payments to be made.<sup>353</sup> Moreover, in the modern era, conversion of 'bank money' to cash may effectively be precluded, or significantly curtailed, by an expanding regulatory and legislative framework combating various forms of illegality, such as tax evasion, organized crime, money laundering, and anti-terrorism. Hence it is the monetary value, or 'commercial-bank money', which is used in payment as 'money', much more than banknotes.

<sup>352</sup> A fact that underlies Hayek's devastating criticism of our current monetary system. See FA Hayek, *Denationalisation of Money – The Argument Refined*, 3rd edn (London: The Institute of Economic Affairs, 1990).

<sup>353</sup> On that point see facts of *Libyan Arab Foreign Bank v Bankers Trust Co* [1989] 3 All E.R. 252; [1988] 1 Lloyd's Rep. 259 (Q.B.), re demand for payment of \$131 million.

However, the attribution of features of money to monetary value cannot hold true without the ability to pass this monetary value quickly, from hand to hand, as if it were banknotes and coins. This could take place in local deposit and transfer banks of the Middle Ages, particularly, if payer and payee were clients of the same banks. On a larger geographical scale this could happen only with the advent of electronic banking, facilitating the fast transfer of funds from place to place.

Both ‘central-bank money’ and ‘commercial-bank money’ are in the form of credit to a bank account.<sup>353.1</sup> However, unlike banknotes and ‘central-bank money’, ‘commercial-bank money’ does not carry with it the obligation of the central bank. However, insofar as it ‘passes freely from hand to hand throughout the community in *final discharge of debts*’ (emphasis added), ‘commercial bank money’ is to be treated as ‘money’.<sup>353.2</sup> Its acceptance in final discharge of debts is premised on the typical intention of the payee by means of a banknote to deposit it in his account – and thereby to bear the risk of default by his own bank. Similarly, a payee receiving ‘commercial-bank money’ bears the risk of default by his own bank. Accordingly, when a creditor agrees to be paid in ‘commercial-bank money’,<sup>354</sup> it is as if he agrees to be paid by receiving banknotes that he intends to deposit to his bank account. Upon the deposit of the banknotes so received, he would have come to be owed by his bank instead of by the issuer of the banknote. Receipt of ‘commercial-bank money’ is a ‘short-cut’ to the same end; it gives a rise to a debt owed to the creditor by his bank which replaces the debt paid by it.<sup>355</sup>

The convertibility of ‘commercial-bank money’ to banknotes and coins ought not to stand in the way of treating ‘commercial-bank money’ as money. Certainly, as discussed in section 3.2 above, a convertible central bank banknote is ‘money’. Does it matter that a central bank is not liable on ‘commercial-bank money’?

Indeed, the fact that the party liable on ‘commercial-bank money’ is not a central bank means that ‘commercial-bank money’ is not backed by the State. This however is not necessarily an obstacle to the view that ‘commercial-bank money’ is ‘money’, unless one ascribes to a very restrictive school of thought under which there is no ‘money’ without a State backing. As was already indicated in section 2.2 above, towards the end of the seventeenth century, it was judicially acknowledged that ‘[t]he notes of goldsmiths . . . are always accounted

<sup>353.1</sup> For their treatment as ‘scriptural money’ explained by one theory see A Sáinz de Vicuña ‘An Institutional Theory of Money’ in Giovanoli and Devos (eds), above n 101 at 517.

<sup>353.2</sup> *Moss v Hancock* [1899] 2 Q.B. 111 at 116. See n 88.1 at text above as well as in ch 1, section 2 above.

<sup>354</sup> For the requirement as to the payee’s agreement to be paid into his bank account, see eg *Mardorf Peach v Attica Sea Carriers; The Laconia* [1977] 1 All E.R. 545 (H.L.).

<sup>355</sup> For the accrual to the payee of ‘the unconditional right to the immediate use of the funds transferred’ as the crucial point for ‘payment’, see *The Brimnes; Tenax Steamship Co Ltd v The Brimnes (Owners)* [1973] 1 All E.R. 769 at 782 (Q.B.D.). For further discussion, see ch 1, section 4.2, text around nn 204–08 above.



among merchants as ready cash.<sup>356</sup> It was however pointed out in section 2.2 above that goldsmith notes may have not been received in final discharge of debts, and thus lacked an important element of 'money'. In contrast, as was just explained, a payee receiving 'commercial-bank money' accepts it in final discharge of the debt. He bears the risk of default by his own bank, and neither the default of the payer nor that of the payer's bank, as in the case of a payee receiving a goldsmith note. Moreover, nowadays, a public deposit insurance scheme may protect a depositor from the insolvency of his bank, at least up to a certain amount, so as to provide at least a limited State backing to 'commercial-bank money'.<sup>357</sup> In the final analysis then, it should not matter that a central bank is not liable on 'commercial-bank money'.

The conceptual difficulty in viewing 'commercial-bank money' as money is rather based on the fact that receipt of 'commercial-bank money' is 'payment' only from the point it becomes the obligation of the payee's bank. That is, a banknote that changes hands in payment is still the same banknote, reflecting the original obligation of its issuer, the central bank, to pay the bearer on demand. Conversely, 'commercial-bank money' is the obligation of the payer's bank while it is in the payer's hands; however, once 'transferred' to the payee's hands, the same amount of 'commercial-bank money' becomes the obligation of the payee's bank. That is, the 'transfer' is actually not a true transfer; it is not an assignment, but rather it is the extinction (or reduction) of one debt between two parties, and the creation (or increase) of a debt between two other parties.<sup>358</sup> It is this metamorphosis that makes it difficult to view 'commercial-bank money' as an 'object' on its own, in the same way that the banknote is viewed. Stated otherwise, now that the assignment of debts is fully recognized,<sup>359</sup> the difficulty in viewing credit to a bank account as money does not stem from the fact that, unlike the banknote, 'commercial-bank money' is an intangible debt; rather, the difficulty is the lack of a close parallel to the 'circulation' of the banknote. Instead of the 'circulation' of 'commercial-bank money', we have the extinction of one 'commercial-bank money' debt, and its replacement by another.<sup>360</sup>

I submit, however, that we ought not to allow form to prevail over substance; inasmuch as 'commercial-bank money' 'flows' rather than 'circulates' and is accepted in the payment of debts, it has become an intangible subject-matter that constitutes 'money'.

<sup>356</sup> *Tassell and Lee v Lewis* (1701), above n 65, and see discussion there.

<sup>357</sup> MS Goodfriend, 'Money, Credit, Banking, and Payment System Policy' in DB Humphrey (ed), *The US Payment System: Efficiency, Risk and the Role of the Federal Reserve* (Boston: Kluwer Academic Publishers, 1990) at 247, mentions deposit insurance as one of the 'diverse institutions' of which the modern payment system consists.

<sup>358</sup> Unless of course the payer and payee use the same bank, in which the debtor-bank remains the same and it is only the two creditors, payer and payee, that switch.

<sup>359</sup> For the assignment of debts in English law, see above ch 9, concluding paragraph to section 1 and the second last paragraph of section 6.

<sup>360</sup> *Libyan Arab Foreign Bank v Bankers Trust Co*, above n 353 at 269 (All E.R.), 273 (Lloyd's); and *R v Preddy* [1996] A.C. 815 (H.L.).

It should be stressed that ‘commercial-bank money’ need not be in deposits of banks that have settlement accounts with the central bank. Rather, as a rule, small banks may not have such settlement accounts, but rather accounts with large banks which in turn have accounts on the books of the central bank. Such a ‘tiered’ payment system is quite common.<sup>361</sup> ‘Payment accounts’ may also be maintained by money transmitters as well as securities intermediaries. Moreover, I submit, customers’ bank accounts may be ‘decentralized’, namely, held and run on ‘stored-value products’ such as cards issued by banks or other entities having account with banks; value is ‘loaded’ on such devices, either through the Internet or in terminals, typically from bank accounts, so as to create what is colloquially referred to as ‘electronic money’.<sup>362</sup> For monetary value to be ‘commercial-bank money’, what is required is linkage to the banking system, which for its part is linked to the central bank.

In sum, paper money in the form of banknotes originated as a payment mechanism, that is, a machinery facilitating the payment of money without incurring the risks of transportation or physical delivery. No wonder then that, at the turn of the eighteenth century, Lord Holt treated the delivery of a goldsmith note as a bill drawn on the goldsmith and instructing him to pay.<sup>363</sup> As an instrument ‘drawn’ on the goldsmith/banker, and yet embodying his engagement to pay money on deposit with him, the banknote began to circulate and became money itself. Having become inconvertible, paper money was the culmination of the process of the evolution of money from an ordinary chattel to a specie of valuable chattel and, finally, into a paper (valueless chattel) containing an abstract promise to pay money.

With the banknote becoming ‘money’, carrying with it the costs of storage and transportation and associated risk, the focus shifted to ‘commercial-bank money’ as a means to avoid such risks. Having generated distinct fraud risks that only increased with the advent of electronic banking, ‘commercial-bank money’ nevertheless eliminated physical security risks and costs associated with storage and transportation of coins and banknotes. As indicated, it also enhanced the State’s power to control various forms of illegality. ‘Commercial-bank money’, transferred by means of payment mechanisms initiated by payment orders, has thus evolved to become a means of payment.

Indeed, ‘commercial-bank money’ flows in a funds transfer by means of a payment order initiating a payment mechanism. At the same time, also the physical delivery of a standard monetary object, be it a coin or banknote, is an instruction to the issuer to make payment to the holder; as such it too is a payment mechanism, triggering an obligation of the issuer, as a paymaster, to the holder. Certainly, for an inconvertible banknote, both the payment order by

<sup>361</sup> For tiered settlement arrangements see eg *Core Principles*, above n 96 at 36.

<sup>362</sup> See eg B Geva and M Kianieff, ‘Reimagining E-Money: Its Conceptual Unity with Other Retail Payment Systems’ (2005), 3 *Current Developments in Monetary and Financial Law* 669, specifically, at 671–87.

<sup>363</sup> See n 75 above. See also text and n 54 above.

means of the delivery and the issuer-paymaster's obligation are sterile. As well, in the case of legal tender, the creditor's agreement to accept the monetary object may be deemed to exist even in the unusual circumstances where he actually protests. However, in the final analysis, with regard to coins and banknotes, other than for the issuer's creditworthiness, particularly in the form of the State's guarantee, the delivery of money is conceptually no different from the instruction to pay money. The circle closed when 'commercial-bank money', that is, monetary value transferred by means of a payment mechanism initiated by a payment order, became 'money'.

All of this was brought to fruition in a process that evolved in post-Medieval England, and in which the modern payment system was born. This chapter explored the process as part of a broader one, that of the emergence of the banking system as a network of banks, linked through a central bank that acts as the issuer of the banknote, and on whose books banks settle. In this framework, in initiating a transfer of monetary value under a payment mechanism, as discussed above in chapter one, section 4, the payment order emerged as a vehicle for generating 'money' itself, and thus for the convergence between 'money' and 'monetary value'.

# Turning the Wheels of Post-Medieval Change: Paper Circulation and Negotiability under English Law

|                                                                                         |     |
|-----------------------------------------------------------------------------------------|-----|
| 1. Introduction                                                                         | 528 |
| 2. Negotiation of Bills Payable to Order                                                | 531 |
| 3. Negotiation of Notes Payable to Order                                                | 533 |
| 4. Negotiation of Instruments Payable to the Bearer                                     | 541 |
| 5. Negotiation of Cheques                                                               | 547 |
| 6. Negotiation and Material Negotiability: Circulation Free from Claims<br>and Defences | 552 |
| 6.1 Introduction                                                                        | 552 |
| 6.2 Freedom from Adverse Claims                                                         | 554 |
| 6.3 Freedom from Contract Defences                                                      | 568 |
| 7. Conclusion: Final Reflections on ‘Negotiation’ and ‘Negotiability’                   | 582 |

## 1. INTRODUCTION

THE TRANSFORMATION OF the banking system in England during the eighteenth and nineteenth centuries is said to have been facilitated by liquidity enhancement in the form of note issuing and bill discounting. These practices appeared in the seventeenth century and acquired dominance only subsequently.<sup>1</sup> This liquidity enhancement facilitated credit expansion in two ways.

First, credit could expand directly, by way of enabling a banker to lend not only coins but also his own banknotes, and against bills of exchange.<sup>2</sup> Second, this liquidity enhancement also expanded credit indirectly, by allowing one banker extending credit to his own customer to rely on credit extended by another banker to another customer, as reflected in a cheque drawn on the other

<sup>1</sup> FC Lane, ‘Venetian Bankers, 1496–1533: A Study in the Early Stages of Deposit Banking’ (1937), 45 *Journal of Political Economy* 187 at 187; as well FC Lane, *Venice A Maritime Republic* (Baltimore: John Hopkins University Press, 1973) at 330.

<sup>2</sup> See ch 10, section 2 above.

banker or banknote issued by it. This strengthened the banking system as a whole and facilitated the interbank transfer of credit without reciprocal balances held by one bank with the other.<sup>3</sup>

The key to all of this was the circulation of paper. Indeed, the discounting of the bill of exchange, the payment by means of a banknote, and the ability both to transfer and deposit a cheque, presuppose that these instruments circulate, that is, are transferred from hand to hand. Furthermore, enhanced circulation further requires, at least in most circumstances, transferability free of third-party claims and prior-parties defences, namely, transferability of an unconditional claim to the sum embodied in the instrument. The former quality, that of transferability by delivery (with or without endorsement), may be referred to as 'transferability with a certain facility' or 'procedural negotiability'. The second, namely, the transferor's power to thereby confer to the transferee a better title than that of the transferor, may be referred to as 'transferability free from equities' or 'material negotiability'.<sup>4</sup>

The legal doctrine facilitating paper circulation is known as 'negotiability.' As indicated, for example, in chapter eight, section 5 above, a 'negotiable instrument' is a document of title to a sum of money, transferable by delivery (either with or without an endorsement), and capable of conferring on the transferee title to it free of a third party's adverse claims and prior parties' defences.<sup>5</sup> Under modern English law,<sup>6</sup> 'negotiation' is the definitive method of transfer of a negotiable instrument,<sup>7</sup> facilitating circulation, namely, the transfer to the new holder of all the benefits of 'negotiability'.<sup>8</sup> The negotiation of a bill of exchange payable to the order requires, in addition to the physical delivery of the bill, its endorsement by the transferor.<sup>9</sup>

<sup>3</sup> AP Usher, *The Early History of Deposit Banking in Mediterranean Europe* (Cambridge, Mass: Harvard University Press, 1943) vol I at 20, 24. This is not to say that the facility may not be abused by overextending credit. See B Hammond, *Banks and Politics in America: From the Revolution to the Civil War* (Princeton, NJ: Princeton University Press, 1957) at 452–53. Though his own example is contested, P Temin, *The Jacksonian Economy* (New York: WW Norton, 1969) at 74–77, it is certainly not repudiated in principle.

<sup>4</sup> See DV Cowen and L Gering, *Cowen on the Law of Negotiable Instruments in South Africa*, 5th edn, vol I: General Principles (Cape Town: Juta, 1985) at 31–36. See also L Gering, *Handbook on the Law of Negotiable Instruments*, 3rd edn (Cape Town: Juta Law, 2007) at 9–15. The terminology distinguishing between 'procedural' and 'material' negotiability is attributed to Justice Y Sussmann, of the Supreme Court of Israel, in his book *The Law of Bills of Exchange*, 6th edn (Jerusalem: Aminon, 1983) at 245 [in Hebrew]. See also A Barak, 'The Nature of the Negotiable Instrument' (1983), 18 *Israel Law Review* 49 at 52.

<sup>5</sup> Cowen and Gering, *ibid* at 52.

<sup>6</sup> *The Bills of Exchange Act, 1882* (UK), 45 & 46 Vic., c. 61 as amended (hereafter: BEA).

<sup>7</sup> *Ibid* s 31.

<sup>8</sup> *Ibid* ss 29(1) and 38(2).

<sup>9</sup> *Ibid* s 31(3). Requirements for 'indorsement' are set out in BEA, *ibid* s 33. See also definition in s 3. According to JM Holden, *The History of Negotiable Instruments in English Law* (London: University of London: The Athlone Press, 1955, reprint 1993, WM W Gaunt & Sons) at 44, fn 6, '[t]he spelling "endorse" is more common than "indorse" in commercial practice'. At the same time, he goes on to say, '[t]he Bills of Exchange Act, 1882, adopted the spelling "indorse"' *Ibid*. I should add that, on that point, the American *Uniform Commercial Code* (U.C.C) Article 3, (1990, as amended 2002) follows suit and uses 'indorse'. In contrast, the Canadian spelling, reflected in the

At the same time, as already indicated above in chapter nine, section 1, '[a]t common law, . . . a debt was looked upon as a strictly personal obligation'<sup>10</sup> and its assignment was prohibited.<sup>11</sup> Hence, 'negotiation', as a method of transfer for any debt, even embodied in paper, appears to be unavailable under the common law. It is thus tempting to invoke 'law merchant' imported from elsewhere as the basis for introducing 'negotiation' to English law, whether by endorsement or otherwise.<sup>12</sup> However, in light of the analysis in chapter nine, section 4 above, denying the validity of 'law merchant' as the basis for the 'reception' of the bill of exchange in England, an alternative explanation is pursued in this chapter.

The ensuing discussion proceeds as follows. Section 2 discusses the negotiation of bills payable to order. Section 3 is concerned with the negotiation of notes payable to order. Both sections argue that transferability by negotiation, namely, procedural negotiability, is a by-product or side-effect of the rule under which the endorsement of a bill or note is tantamount to the issue of a new bill.

Section 4 deals with the negotiation of bills and notes payable to bearer. It attributes the rule providing that the delivery of an instrument payable to bearer effects a transfer of title thereto to the realization that notwithstanding the new bill theory, in practice, an endorsement completed by delivery facilitated a transfer of the instrument payable to order, namely, procedural negotiability. Hence, it became impossible to resist the extension of a similar effect to the physical transfer, albeit unaccompanied by signature, of an instrument payable to the bearer.

Section 5 explains the negotiation of cheques as premised on the treatment of the cheque as a specie of the bill. However, the cheque did not, in fact, evolve out of the bill of exchange; hence, it is argued, there was an awareness that the characterization of the cheque as a bill of exchange was artificial; in fact, this characterization was a victory of form over substance. The section argues that awareness of this fact underlay the delay in the recognition that the negotiation of the cheque transferred title thereto, exactly as in the case of the bill.

Section 6 discusses material negotiability, namely instrument circulation by negotiation free of adverse property claims and contract defences. It argues that freedom from claims goes back to the 'currency' of the banknote, namely to its treatment as money. It further analyses the extension of freedom from claims to apply to bills and notes payable to order so as to enhance bill-discounting. The section assesses this aspect of negotiability, protecting an instrument holder from adverse claims, to be in line with statutory rules that developed to protect

*Bills of Exchange Act*, R.S.C. 1985, c. B-4, and adopted by me in this text, is 'endorse'.

<sup>10</sup> *Fitzroy v Cave* [1905] 2 K.B. 364 at 372.

<sup>11</sup> The objections to assignability of choses in action in the common law are summarized eg by WR Warren, *The Law Relating to Choses in Action* (London: Sweet & Maxwell, 1899) at 31–32. They include maintenance, the duty of a debtor to seek out his creditor, and the need to complete transfer of ownership by means of physical delivery.

<sup>12</sup> As in fact claimed by Holden, above n 9 at 73–74. This view appears to be judicially sanctioned in *Goodwin v Robarts* (1875) L.R. 10 Ex. 337, aff'd (1875–76), L.R. 1 A.C. 476 (H.L.).

certain buyers of goods. The discussion also highlights the limits of the freedom of a holder of an order paper from adverse claims. Finally, section 6 addresses the freedom from contract defences. It argues that, while bringing the 'currency' quality of the negotiable instrument to perfection, this aspect of negotiability does not stand on firm ground, at least as a universal rule, either doctrinally or as a matter of policy.

Section 7 concludes with final reflections on 'negotiation' and 'negotiability'. This concluding section is a brief outline putting the evolution set out in the chapter against the background of a broader perspective.

## 2. NEGOTIATION OF BILLS PAYABLE TO ORDER

I argue that, at its inception, as a matter of common law doctrine, the endorsement of a bill of exchange payable to order was not conceptualized at all as a mechanism designed to facilitate the transfer of the bill. Rather, by endorsing a bill, the endorser incurred liability on it. In fact, under modern law, an endorser not only transfers the instrument<sup>13</sup> but also incurs liability thereon.<sup>14</sup> Indeed, liability can nowadays be waived,<sup>15</sup> and hence is incidental to the transfer. However, I argue that historically, in the footsteps of the Continental explanation to the emergence of the endorsement,<sup>16</sup> as a matter of legal doctrine, the endorsement was perceived in English law only as a basis for liability. It was the impact as well as the desired effect of that liability that created both the appearance and actual results of a transfer. In short, historically, as a matter of legal doctrine, liability was the principal, while transfer was incidental.

Indeed, as discussed in chapter nine, section 4 above, in *Anon* (1694) Lord Holt theorized the endorsement as 'quasi a new bill, and a warranty by the indorser, that the bill shall be paid.'<sup>17</sup> This was also the theory of *Williams v Field* (1694) where it was held that since 'every indorsement is a new bill', 'the last indorsee may bring an action against any of the indorsers.'<sup>18</sup> However, by itself the treatment of the endorsement as 'a new bill' would have justified the endorser's liability to his own payee, namely the immediate endorsee. However, in both cases cited above, this rationale was used to allow the last endorsee to sue the first endorsee, with whom he was not in privity. Even earlier, in *Claxton v Swift* (1685),<sup>19</sup> the drawer's liability to the last endorsee was assumed to exist.

This appears to support an explanation premised on the effect of the transfer or assignment of the instrument; however, an assignment of debts is not the

<sup>13</sup> BEA, above n 6, s 31.

<sup>14</sup> *Ibid* s 55(2).

<sup>15</sup> *Ibid* s 16(1).

<sup>16</sup> See ch 8, section 5 above, particularly at text around nn 282–92.

<sup>17</sup> Holt, K.B. 115, 90 E.R. 962.

<sup>18</sup> 3 Salk. 68, 91 E.R. 696. For an earlier obiter to that effect see *Hodges v Steward* (1692), 1 Salk. 125, 91 E.R. 117 (second point).

<sup>19</sup> 3 Mod. 86, 87 E.R. 55.



only theory on which a successful action on a bill of exchange by a remote party could be rationalized. In fact, the earlier seminal case of *Chat and Edgar Case* (1663)<sup>20</sup> involved a successful action of the payee against the drawer in circumstances where there was no privity between them.<sup>21</sup> In fastening liability on the drawer in 'an action upon the case' brought by the payee, the court in *Chat and Edgar Case* purported to rely on 'the custom of merchants';<sup>22</sup> thus, almost in passing and relying on custom as a source of innovation in the common law, the court expanded the frontiers of liability and a major innovation came about: a drawer was held liable to a payee even in the absence of privity and actual intention to benefit him, and notwithstanding the failure of consideration between the drawer and the remitter. Indeed, if a drawer's liability could be upheld against a plaintiff-payee without privity or intention to benefit, it is only logical that a drawer, as well as an endorser, could be held liable to a plaintiff-remote endorsee without privity or intention to benefit him.<sup>23</sup>

Stated otherwise, in drawing or endorsing a bill of exchange, each party assumed liability not only to the party with whom he was in privity, but also to any subsequent holder. Indeed, this may appear to be premised on the transfer of a bill of exchange by means of its endorsement; some case law may even be cited as lending support to this proposition.<sup>24</sup> However, as indicated, the theoretical reasoning had to do with extending liability towards a party not in privity, and not with the transfer of the instrument. In other words, the obligation of a drawer and each endorser of a bill is to pay the holder; in the footsteps of the analysis in chapter nine, section 4 above, the holder became entitled to sue on it on the basis of the expansion of frontiers of liability by custom.

In fact, the endorsement operates to circulate credit on a similar basis to that of the re-delegation in Roman law.<sup>25</sup> As discussed in chapter five, section 10.2 above, under Roman law, credit could circulate where, having become entitled to receive payment from Paymaster (corresponding to the drawee of a bill of exchange), the delegatee-Creditor (corresponding to the payee of a bill) re-delegates Paymaster-Drawee to make payment to E (corresponding to the first endorsee of a bill), who may be Creditor-Payee's own creditor. In such a case, 'double delegation' is involved; first, on the bill of exchange as drawn, by Debtor (corresponding to the drawer of a bill) to Paymaster-Drawee to pay Creditor-Payee, and second, by Creditor-Payee to Paymaster-Drawee to pay Endorsee. In principle, Endorsee may further delegate Paymaster-Drawee to pay F, who may

<sup>20</sup> 1 Keble 636, 83 E.R. 1156.

<sup>21</sup> In the facts of the case, a payee-seller sued a drawer-parson who acted as a paymaster for the remitter-buyer. See ch 9, section 5, text around nn 228–40 above.

<sup>22</sup> Above n 20.

<sup>23</sup> Which seems to be the observation of JH Baker, 'The Law Merchant and the Common Law Before 1700' (1979), 38 *Cambridge Law Journal* 295 at 311.

<sup>24</sup> *Hodges v Steward*, above n 18 (first point). And yet the court linked this reasoning to the new bill created by the endorsement. *Ibid.*

<sup>25</sup> See ch 5, text and n 275 above. Roman law could have explained the endorsement also by reference to cession. *Ibid.*

be Endorsee's creditor, and so on down an infinite chain. In each such a case, Paymaster-Drawee will ultimately pay the last endorsee in the chain. Along the chain, any endorsement is tantamount to an imperfect execution that does not release prior delegators; towards each delegator, Paymaster-Drawee is a mandatary, entitled to reimbursement and hence discharge from each delegator (Drawer or Endorser) under the terms of the respective mandate. In connection with the imperfect execution along the chain, it is then performance by payment to the ultimate delegatee-endorsee that discharges Paymaster-Drawee and each delegator (drawer and endorsers).

### 3. NEGOTIATION OF NOTES PAYABLE TO ORDER

Conferring transferability by negotiation on the promissory note proved to be more challenging. In essence, under modern law, a promissory note ('note') is a credit instrument under which a debtor ('maker') promises to pay his creditor ('payee' or 'bearer').<sup>26</sup> It is thus fundamentally different from a bill of exchange ('bill') which is an order. True, both have developed to contain 'unconditional' language;<sup>27</sup> however, while the bill is an unconditional order,<sup>28</sup> the note is an unconditional promise.<sup>29</sup> An order and promise are different from each other, so as to provide the key to the distinction between the bill and note. Also, on its own, as a promise and not an order to pay, the note is not a payment mechanism; as such it appears to fall outside the scope of this study. At the same time, the endorsement of a note payable to order, for example, in payment of a debt owed by the endorser to the endorsee, is a payment mechanism, under which the endorser is the debtor, the note maker is the paymaster, and the endorsee is the creditor. Finally, at their inception, banknotes could be made payable to order;<sup>30</sup> hence their transfer by negotiation was indispensable in order to confer on them the currency quality. Consequently, the endorsed note, that is, the negotiation of a note payable to order, falls within the ambit of this study.

Goldsmith notes and, later, Bank of England notes, as well as credit obligations by merchants<sup>31</sup> and repayment obligations of borrowers to their goldsmith-lenders, were promissory notes; to accommodate their use as a source of liquidity, merchants required transferability. Certainly, under the common law, this was impossible for ordinary debt instruments.<sup>32</sup> Hence, for notes payable to

<sup>26</sup> BEA, above n 6, s 83(1).

<sup>27</sup> See eg *Carlos v Fancourt* (1794), 5 T.R. 482; 101 E.R. 272.

<sup>28</sup> BEA, above n 6, s 3(1).

<sup>29</sup> *Ibid* s 83(1).

<sup>30</sup> Indeed, '[t]he notes of goldsmiths (whether they be payable to order or to bearer) are always accounted among merchants as ready cash.' *Tassell and Lee v Lewis* (1701) 1 Ld. Raym. 743 at 744, 91 E.R. 1397 at 1398 (K.B.).

<sup>31</sup> Whose Continental origins and practice as 'bills obligatory' are discussed by G Malynes, *Consuetudo, Vel Lex Mercatoria* (London: printed by Redmayne, 1685, reprint Abingdon, England: Professional Books, 1981) at 72–76.

<sup>32</sup> See text at nn 10–11 above.

a named creditor, it was tempting to attempt to achieve the result of a transfer by means of an endorsement; as on a bill of exchange, the endorsement on a note would have been a bill, instructing the maker to pay the endorsee.

For this to work, the note would have to be put on an equal footing as a bill of exchange. After some confusion on the matter,<sup>33</sup> Lord Holt ruled decisively against anything of that sort. The landmark case is *Clerke v Martin* (1702).<sup>34</sup> This was an action by a payee-lender against his borrower, maker of a promissory note. One count was 'upon the custom of merchants, as upon a bill of exchange.' However, Lord Holt did not fail to overlook the obvious, that is, that the instrument sued upon was a promise and not an order, and stated that 'this note could not be a bill of exchange'. Accordingly, he held that the theory underlying that cause of action 'amounted to the setting up a new sort of specialty, unknown to the common law, and invented in Lombard-Street, which attempted . . . to give laws to Westminster-Hall.'<sup>35</sup> Around the same time he also consistently ruled elsewhere, on behalf of an entire court, that 'a declaration upon the *custom of merchants* upon a note . . . was void; for it tended to make *a note . . . to a specialty*' (emphasis in original).<sup>36</sup>

Notwithstanding Holdsworth<sup>37</sup> and Street,<sup>38</sup> who appear to have taken such language literally, it is unlikely that Lord Holt truly assumed that the 'law merchant' turned the bill of exchange, for all intents and purposes, to a specialty without a seal, which is nevertheless subject to all the rules governing a specialty; as such, the instrument would have been governed by the rule which

<sup>33</sup> See eg *Hill v Lewis* 91 E.R. 124 (1709) 1. Salk. 132, 91 E.R. 124, in which Lord Holt states that 'goldsmiths [*sic*] bills were governed by the same laws and customs as other bills of exchange.' Arguably however (and contrary to JS Rogers, *The Early History of the Law of Bills and Notes: A Study of the Origins of Anglo-American Commercial Law* (Cambridge: Cambridge University Press, 1995) at 178 (hereafter: Rogers, *Bills and Notes*) he had in mind goldsmiths' inland bills and not promissory notes. Alternatively, and in line with Rogers, as pointed out in text that follows n 77 below, Lord Holt may have been prepared to set aside goldsmith notes from other promissory notes so as to be governed by rules applicable to bills of exchange. See also *Williams v Williams* (1693) Carth. 269, 90 E.R. 759. But notwithstanding RD Richards, *The Early History of Banking in England* (New York: AM Kelley, 1965, reprint of 1929 edition) at 48 (and in fact Holden, above n 9 at 81), while indeed, this was an action by an endorsee on a note, on the point of endorsement, the court did not go beyond stating that 'custom of merchants concerning bills of exchange is part of the common law.' *Ibid* at 270 (Carth.), 760 (E.R.).

<sup>34</sup> 2 Ld. Raym. 757, 92 E.R. 6.

<sup>35</sup> *Ibid* at 758 (Ld. Raym.), 6 (E.R.).

<sup>36</sup> *Cutting v Williams* (1702) 7 Mod. 154 at 155; 87 E.R. 1160 at 1161.

<sup>37</sup> W Holdsworth, *A History of English Law*, 2nd edn (London: Methuen, Sweet & Maxwell, 1937, reprint 1966) vol VIII at 168, 175.

<sup>38</sup> TA Street, *The Foundations of Legal Liability* vol II: History and Theory of English Contract Law (Northport, Long Island, NY: Edward Thompson, 1906) at 381. For attributing to Lord Holt the view that 'contracts within the custom of merchants do not' require a consideration, Street also relied (*ibid* at 383) on *Cramlington v Evans* (1689) 1 Show K.B. 4, 89 E.R. 410. However, I agree with Holden, above n 9 at 62–63 that in stating there (*ibid* at 5 (Show), 410 (E.R.)) that receipt of value is not required to be declared in an action on a bill brought 'upon the custom of merchants' Lord Holt must be taken to allude (as discussed in the following paragraph) to the existence (for the plaintiff-holder's benefit) of a presumption as to the existence of consideration rather than to its dispensation altogether.

fastens liability without consideration.<sup>39</sup> Certainly, 'the ancient common-law specialty' was 'the instrument under seal'<sup>40</sup> and it is far fetched to assume that Lord Holt thought otherwise. Treating an unsealed document as a specialty<sup>41</sup> would have been unorthodox;<sup>42</sup> In fact, elsewhere Lord Holt was quoted to specifically say that '[a] bill of exchange is in law no specialty'.<sup>43</sup>

Arguably, then, in *Clerke v Martin* (1702), in Lord Holt's mind, the bill of exchange was tantamount to a specialty, in a limited and really not strictly technical sense, only insofar as the plaintiff thereon benefits from certain rules that do not apply to other simple contracts. One such a rule provides for a rebuttable presumption as to the existence of consideration, so as to entitle one suing on a bill of exchange to a judgment by the mere production of the instrument signed by the defendant, unless lack of consideration is proven.<sup>44</sup> Other rules may exempt a plaintiff from some defences available to a defendant suing on a simple contract.<sup>45</sup> Stated otherwise, in the mind of Lord Holt, being unsealed, the bill of exchange remained a 'simple contract.' Nevertheless, compared to an ordinary 'simple contract', the bill enhances a plaintiff's rights. Thus, while not changing its classification under the common law, the bill practically became a sort of a 'modern mercantile specialty',<sup>46</sup> conferring benefits on the plaintiff suing thereon. However, such benefits fall short of those conferred on one suing on a 'true' specialty. In this sense, particularly taking into account that a note may be made out by a non-merchant,<sup>47</sup> Lord Holt's objection must be taken to refer to the accordance of such benefits to the holder of a promissory note, even not as a 'fully blown' specialty under seal. For Lord Holt, the note should have stayed a 'simple contract' governed by regular common law rules.

<sup>39</sup> For a specialty obligation that owes its validity only to its formal execution independently of any consideration see eg JB Ames, 'Specialty Contracts and Equitable Defenses' in JB Ames, *Lectures in Legal History and Miscellaneous Legal Essays* (Cambridge, Mass: Harvard University Press, 1913) at 104.

<sup>40</sup> Ames, *ibid* at 115.

<sup>41</sup> For a specialty as a contract under seal, particularly in connection with a monetary debt, see eg *R v Williams* [1942] A.C. 541 at 555 (P.C.).

<sup>42</sup> Thus, according to J Marius, *Advice Concerning Bills of Exchange* (London: printed for Robert Horne, 1684) at 1, in the absence of formalities such as seal, delivery and witnessing, the bill of exchange 'cannot properly . . . be called a *Specialty*' (emphasis in original).

<sup>43</sup> *Anon* (1694), above n 17.

<sup>44</sup> The point is made by Rogers, *Bills and Notes*, above n 33 at 180–81. The rule was settled in *Josceline v Lassere* (1714) Fortescue 281, 92 E.R. 853 (for bills) and in *Brown v Marsh* (1721) Gilb. Rep. 154, 25 E.R. 108 (for notes); it is now codified in BEA, above n 6, s 30(1). The omission of consideration in the plaintiff's declaration (now codified in BEA s 3(3)(b)) is traced by Rogers, *ibid* at 136–37, eg to *Oaste v Taylor* (1612) Cro. Jac. 306, 79 E.R. 262.

<sup>45</sup> This aspect will be addressed below in this chapter, in section 6.3.

<sup>46</sup> The expression was coined (with regard to both the bill and note) by Ames, above n 39 at 115, text and fn 2, who nonetheless may be taken to criticize the rigid common law classification which forces negotiable instruments to be treated as 'simple contracts'.

<sup>47</sup> See eg *Pearson v Garrett* (1693) 4 Mod. 242, 87 E.R. 371.

In any event, Lord Holt's decision in *Clerke v Martin* (1702) was not received well;<sup>48</sup> shortly thereafter, it was overruled by the *Promissory Notes Act, 1704*, providing that notes payable to order<sup>49</sup> are 'assignable or indorsible over within the Custom of Merchants' and 'in the same Manner as Inland Bills of Exchange'.<sup>50</sup> As a matter of history, this certainly settled the matter. However, the controversy sheds light on the nature, scope and role of the 'law merchant', particularly in relation to both mercantile practice and the general common law of contract. The controversy further illuminates the boundaries among various mercantile instruments and resulting issues as to their legal treatment.

Thus, in line with the analysis of chapter nine, section 4 above, Lord Holt must have viewed 'law merchant' as a fiction allowing the expansion of the frontiers of liability on instruments introduced by merchants. The bill of exchange was such an instrument. Conversely, the common law certainly recognized the bond, deed, or bill obligatory, as a 'specialty', that was a formal writing under seal on which the debtor was liable in Debt on an Obligation.<sup>51</sup> Certainly, in *Clerke v Martin* (1702), in the absence of a seal, Lord Holt saw no reason to object to the lender's action against a borrower in *Indebitatus Assumpsit*.<sup>52</sup> Hence, he saw no need to equip the lender with an alternative special action that would have amounted to creating a quasi-specialty without a seal. In the final analysis, his position was that it is 'Westminster Hall' that gives laws to 'Lombard Street' and not vice versa.<sup>53</sup>

It is noteworthy that *Clerke v Martin* (1702) did not deal at all with the transferability or endorsement of notes, and yet its implication was obviously against any such practice. This explains the outcry against the case, as well as the swift legislative reaction. Arguably, as a matter of legal doctrine, against the common law prohibitions on the transfer of a debt, it was less of a change to declare the note as governed by the law merchant than to make it transferable under

<sup>48</sup> This may be an understatement. The 'deluge' of criticism is summarized by Holden, above n 9 at 80–84. For a forceful (and in my view convincing) defence of Lord Holt, see Rogers, *Bills and Notes*, above n 33 at 177–86.

<sup>49</sup> Or more specifically, 'Notes in Writing signed by the Party who makes the same whereby such Party promises to pay unto any other Person or his Order any Sum of Money therein mentioned.' However, the marginal note refers to 'Promissory Notes'.

<sup>50</sup> 3 & 4 Ann. c. 8 (Chapter IX in the Common Printed Editions) s 1 (Preamble). Per s XII, the Act was passed to be effective for three years. The first three sections of the Act (albeit lumped as s 1) are reproduced in Holden, above n 9 at 327 (Appendix C). For the subsequent extension of the Act until its repeal by the BEA, above n 6, see Holden, *ibid* at 327, fn 1.

<sup>51</sup> For Debt on Obligation, namely, on a document deed under seal, see eg JH Baker, *An Introduction to English Legal History*, 4th edn (London: Butterworths, 2002) at 323–26. See also MM Postan, 'Private Financial Instruments in Medieval England' (1930), reprinted in MM Postan, *Medieval Trade and Finance* (Cambridge: Cambridge University Press, 1973) at 28, and AWB Simpson, 'The Penal Bond with Conditional Defeasance' in AWB Simpson, *Legal Theory and Legal History: Essays on the Common Law* (London: Hambledon Press, 1987) at 143.

<sup>52</sup> One count in that case was 'upon a general indebitatus assumpsit for money lent to the defendant.' Above n 34 at 757 (Ld. Raym.), 6 (E.R.).

<sup>53</sup> See text at n 35 above.

common law. It is thus that bills and notes were ceremonially married; confirmed under the *Bills of Exchange Act*,<sup>54</sup> this marriage has not been repudiated.

It is, however, unlikely that Lord Holt was unaware of the impact of his decision in *Clerke v Martin* (1702) on the endorsement of promissory notes. It is tempting to speculate then that Lord Holt had in mind a theoretical objection to the endorsement of notes. Thus, the argument goes, he might have thought that as a 'new bill',<sup>55</sup> an endorsement could naturally be planted on an original bill; it did not change the nature of the liability of either drawer or drawee/acceptor but merely redirected them to a new holder. Conversely, to allow a 'new bill' to be planted on a note would effectively turn the maker into a drawee/acceptor, instructed to pay to a new holder. However, upon reflection, this objection is quite tenuous; after all, there is no difference between the liability of a maker of a note and that of an acceptor of a bill.<sup>56</sup> Indeed, elsewhere, the position that the endorsement of a note is tantamount to a new bill of exchange is attributed to Lord Holt.<sup>57</sup> Moreover, after the *Promissory Notes Act*, 1704, the characterization of an endorsement of a note as a new bill was specifically confirmed.<sup>58</sup>

*Buller v Crips* (1703),<sup>59</sup> decided between *Clerke v Martin* (1702) and the enactment of the *Promissory Notes Act*, 1704, unequivocally proves that it was not the objection to the endorsement of a promissory note that underlay Lord Holt's decision in *Clerke v Martin*. Thus, in *Buller v Crips*, an endorsee brought an action 'against him that drew [the note]', declaring 'upon the custom of merchants as upon a bill of exchange' (emphasis in original).<sup>60</sup> In declining to distinguish between this case and *Clerke v Martin*, Lord Holt spoke unfavourably of the endorsement of notes; as for such endorsement:

[I]t would impower one to assign that to another which he could not have himself; for since he to whom this note was made could not have this action, how can his assignee have it? And these notes are not in the nature of bills of exchange; for the reason of the custom of bills of exchange is for the expedition of trade, and its safety; and likewise it hinders the exportation of money out of the realm.<sup>61</sup>

At the same time, in line with an even earlier statement by him in *Tassell and Lee v Lewis* (1701) that '[a] goldsmith's note indorsed is as a bill of exchange to

<sup>54</sup> BEA, above n 6, s 89(1), under which in principle, 'the provisions of [the BEA] relating to bills of exchange apply, with the necessary modifications, to promissory notes.' See also the BEA subtitle, under which it is 'An Act to codify the law relating to Bills of Exchange, Cheques, and Promissory Notes'.

<sup>55</sup> See text at n 35 above.

<sup>56</sup> For the acceptance of a bill as amounting 'to a promise to pay', see *Anon* (1668), Hardres 485 at 486, 145 E.R. 560, identified in *Browne v London* (1670) 1 Mod. 285 at 286, 86 E.R. 889 as 'Milton's case'. In principle, under present BEA, above n 6, s 89(2), 'the maker of a note shall be deemed to correspond with the acceptor of a bill.'

<sup>57</sup> *Tassell and Lee v Lewis*, above n 30 at 744 (Ld. Raym.), 1398 (E.R.).

<sup>58</sup> *Harry v Perrit* (1711) 1 Salk. 133, 91 E.R. 126.

<sup>59</sup> 6 Mod. 29, 87 E.R. 793.

<sup>60</sup> *Ibid* at 29 (Mod.), 793 (E.R.). Note the treatment of the originator of the note as 'drawer' (as on a bill) rather than as a maker.

<sup>61</sup> *Ibid* at 29 (Mod.), 793–94 (E.R.).

the indorser',<sup>62</sup> he specifically conceded in *Buller v Crips* (1703), with respect to a promissory note, that:

if the indorsee had brought this action against the indorser it might peradventure lie; for the indorsement may be said to be tantamount to the drawing of a new bill for so much as the note is for upon the person that gave the note; or he may sue the first drawer in the name of the indorser, and convert the money when recovered to his own use; for the indorsement amounts at least to an agreement that the indorsee should sue for money in the name of the indorser, and receive it to his own use; and besides, [the endorsement] is a good authority to the original drawer to pay the money to the indorsee.<sup>63</sup>

These two passages appear to be inconsistent; the first questions even the payee's cause of action, while the latter recognizes, albeit to a limited extent, the effect of the endorsement of a note.<sup>64</sup> It is in fact a third passage from *Buller v Crips* (1703) that holds the key to the understanding to Lord Holt's position:

[T]he notes in question are only an invention of the goldsmiths in Lombard-Street, who had a mind to make a law to bind all those who did deal with them; and sure to allow such a note to carry any lien with it were to turn a piece of paper, which is in law but evidence of a parol contract, into a specialty.<sup>65</sup>

Thus, Lord Holt may have tried to arrest a process under which the mythic 'law merchant', before then a 'custom of the realm' controlled by the common law,<sup>66</sup> becomes a tool under which merchants themselves make the law, and not only for themselves. He thus viewed the division between informal and formal contracts, parol contract and 'specialty' contracts under seal, as being worked out in the common law in that period,<sup>67</sup> to be satisfactory; hence he saw no need for 'elevating' the promissory note, by making it governed by the law of bills of exchange, thereby effectively transforming 'a parol contract . . . into a specialty.'<sup>68</sup>

Indeed, it is obvious that Lord Holt was supportive of mercantile customs, and was prepared to let them play a role; in fact, in *Buller v Crips* (1703), he 'remember[ed]'<sup>69</sup> that in *Tassell and Lee v Lewis* (1701) he had admitted and 'approved' evidence as to 'custom of merchants' regarding protest requirements upon the dishonour of a foreign bill.<sup>70</sup> In *Buller v Crips* (1703) he also wished to ensure that his ruling would not hinder commerce; he thus even went as far as to

<sup>62</sup> Above n 30 at 744 (Ld. Raym.), 1398 (E.R.).

<sup>63</sup> Above n 59 at 29–30 (Mod.), 794 (E.R.).

<sup>64</sup> Whether this quote qualifies (or contradicts) the quote (at text at n 62 above) from *Tassell and Lee v Lewis*, (above n 30) will not be dealt with here.

<sup>65</sup> Above n 59 at 29 (Mod.), 793 (E.R.).

<sup>66</sup> For the 'law merchant' in this context, see ch 9, section 4 above.

<sup>67</sup> Albeit the division crystallized, ie, was confirmed, only in *Rann v Hughes* (1778) 7 T.R. 350, n. (a), 101 E.R. 1014, n. (a), where it was specifically held that '[a]ll contracts are, by the laws of England, distinguished into agreements by specialty, and agreement by parol . . . If they be merely written and not specialties, they are parol, and a consideration must be proved.'

<sup>68</sup> Above n 59 at 29 (Mod.), 793 (E.R.).

<sup>69</sup> *Ibid.*

<sup>70</sup> Above n 30 at 743 (Ld. Raym.), 1398 (E.R.).



propose to merchants that a party wishing to be obligated to his creditor on a circulating paper, instead of making out a promissory note payable to his creditor, could accept a bill drawn on himself by, and payable to, that creditor.<sup>71</sup>

However, Lord Holt was cognizant of the need to draw a line, and possibly even became alarmed to hear from ‘two of the most famous merchants in London’ that ‘not only *notes*, but *bonds* for money’, namely, documents under seal, ‘were transferred frequently, and indorsed as *bills of exchange*’ (emphasis in original).<sup>72</sup> In his view, this must have been an unwarranted intrusion of mercantile practice into the common law, and he was determined to put an end to it. Arguably, for that reason, he would not allow an action on a note without proof of consideration; such an action is of course available on both a contract under seal<sup>73</sup> and the bill of exchange.<sup>74</sup> This is the explanation to the first quoted paragraph from *Buller v Crips* (1703).<sup>75</sup> At the same time, and this is in fact quite startling, he would not object to the endorsement of an ordinary document containing a promise to pay, and classified as a ‘parol contract’; this is however only as long as the document does not equip the payee with rights other than on a simple contract, and the endorsement is of limited effect, so as to authorize the endorsee to collect on behalf of the endorser, against whom the endorsee is nevertheless allowed to keep the proceeds. This is the explanation to the second quoted paragraph from *Buller v Crips*.<sup>76</sup>

From this perspective, Lord Holt cannot be faulted for endeavouring to constrain the reach of ‘Lombard Street’ into ‘Westminster Hall’, namely to draw a line between usage and law, or perhaps between specific commercial law and a general law of contract. In effect, he was arguing for a restricted reach of inroads made by both mercantile practice and ‘law merchant’ into general common law. Earlier, in *Tassell and Lee v Lewis* (1701), he was prepared to recognize that ‘[t]he notes of goldsmiths (whether they be payable to order or bearer) are always accounted among merchants as ready cash, and not as bills of exchange’, so as to give rise to special rules applicable to them, such as the existence of a right to immediate payment on them.<sup>77</sup>

In short, Lord Holt saw no contradiction between (i) the treatment of a bill and note differently, that is, treating the former as a (quasi) ‘specialty’ under the ‘law merchant’ and the latter as an ordinary parol contract, and (ii) while recognizing that the goldsmith note is a species of a note, giving it a special status that makes it governed by rules closer to those governing a bill than an ordinary note. Both *Clerke v Martin* (1702) and *Buller v Crips* (1703) did not involve goldsmith notes;

<sup>71</sup> His suggestion was as follows: ‘if A. has money to lodge in B.’s hands, and would have a negotiable note for it, it is only saying thus: “Mr. B. pay me, or order, so much money value to yourself;” and signing this, and B. accepting it’. Above n 59 at 30 (Mod.), 794 (E.R.) (emphasis in original).

<sup>72</sup> *Ibid* at 30 (Mod.), 794 (E.R.).

<sup>73</sup> See text and n 39 above. See Rogers, *Bills and Notes*, above n 33 at 178–79.

<sup>74</sup> See text and n 44 above.

<sup>75</sup> See text at n 61 above.

<sup>76</sup> See text at n 63 above.

<sup>77</sup> Above n 30 at 744 (Ld. Raym.), 1398 (E.R.).

rather, they involved promissory notes containing ordinary debt obligations. Arguably, this was the basis of his reservations; it is the 'ordinary' promissory note rather than the goldsmith note which was the target of his critique. Indeed, as contended by Rogers,<sup>78</sup> it is likely that the goldsmiths sought 'negotiability' not only for their notes, but also for those of their borrowers, and that it is on this ground that they were alarmed by Lord Holt's judgments.

As Rogers further correctly pointed out, the scope of the law of negotiable instruments has been a perennial issue;<sup>79</sup> in fact, this is a battle that still erupts from time to time.<sup>80</sup> Far from being a 'hasty, intemperate decision',<sup>81</sup> *Clerke v Martin* (1702) is then a thoughtful judgment. Contrary to the massive criticism that was mounted against Lord Holt,<sup>82</sup> the fact that he was 'corrected' by statute only proves his point as to the limits of mercantile practice to directly create the law, rather than being addressed by it.<sup>83</sup> Indeed, on its own, as a promise and not an order to pay, the note is not a bill; as such it is not a payment mechanism. Certainly Lord Holt was not overruled on that point. However, as of the *Promissory Notes Act, 1704*, an effective endorsement of a note allows a payee to pay with it to his creditor, thereby, turning it to an order directed to the maker to pay the endorsee. The same applies to any subsequent endorsement. Effectively then, the first endorsement of a note initiates a payment mechanism exactly like the order to pay on a bill of exchange.

In the final analysis, Lord Holt may be understood as treating the goldsmith note as a quasi-'specialty' governed by the 'law merchant' on the same footing as the bill of exchange. In being prepared to accord endorsability for the promissory note under general law, he can also be seen as attempting to balance the common law with mercantile requirements. However, it will be pointed out that the option of an endorseable ordinary written document, as proposed by Lord Holt, albeit almost in passing,<sup>84</sup> has not been taken up, and seems to have never been pursued.<sup>85</sup>

<sup>78</sup> Rogers, *Bills and Notes*, above n 33 at 184.

<sup>79</sup> *Ibid* at 185–86.

<sup>80</sup> Possibly, the most recent major eruption involved consumer notes. See eg B Geva, *Financing Consumer Sales and Consumer Defences in Canada and the United States* (Toronto: Carswell, 1984) (hereafter: Geva, *Financing*).

<sup>81</sup> As claimed eg by W Cranch, 'Promissory Notes Before and After Lord Holt' in AALS (ed), *Select Essays in Anglo-American Legal History* (Boston: Little, Brown, and Co, 1909) vol 3 at 72 at 92, who further was 'at a loss' as to the motive and grounds on which Lord Holt 'could at once undertake to overrule' earlier cases under which (allegedly) both inland bills and promissory notes were 'within the custom of merchants.' *Ibid* at 89.

<sup>82</sup> See text and n 48 above.

<sup>83</sup> Certainly, as reported by Holden, above n 9 at 80, fn 2, Lord Holt's adversaries claim that the Act was merely declaratory, that is, that it 'was passed simply to restore the old order of things, which had been disturbed by Lord Holt.' Cranch, above n 81 at 93. This position seems to be premised on both adherence to a mythic 'law merchant' and confidence in the 'omnipotence' of common law courts to resolve any conceivable issue without any legislative aid. To the modern mind, both views appear to be anachronistic.

<sup>84</sup> See text at nn 63–64 and 76 above.

<sup>85</sup> In fact, the need for it has been bypassed with the recognition by equity in the assignment of debts, for which no formal procedure (endorsement or otherwise) is required. Principles of equity

On the other hand, it is noteworthy that the *Promissory Notes Act, 1704* did not go all the way to ignore Lord Holt's premises; for example, it did not allow for the transfer by negotiation and hence the circulation of writings under seal such as bonds. Moreover, a close reading of the statute reveals that it equated notes to bills only insofar as their assignment and endorsement and the independent cause of action of the endorsee are concerned; in fact, nowhere does the Act state that a note is subject to all rules, even with 'the necessary modifications', that govern bills. This equation, ultimately codified in the *Bills of Exchange Act*,<sup>86</sup> had crystallized only after the *Promissory Notes Act, 1704*.<sup>87</sup> As well, Lord Holt was certainly correct in declining to view a promissory note to be the same as an inland bill for all intents and purposes; as indicated,<sup>88</sup> the note is a promise and the bill is an order, which is sufficient to make them distinct and separate.<sup>89</sup> However, this distinction was not considered to be a sufficient reason to refrain from facilitating the endorsement of a note so as to make the endorsable note equivalent to a bill. When endorsed, the note payable to order is effectively stated to be a true equivalent to a bill.<sup>90</sup>

#### 4. NEGOTIATION OF INSTRUMENTS PAYABLE TO THE BEARER

As already indicated, instruments containing a bearer clause, making them payable to bearer, are of Eastern origin; there, they go back to Antiquity<sup>91</sup> and, subsequently, to the early Middle Ages, in both Islamic and Jewish payment instruments.<sup>92</sup> As noted, such instruments subsequently reappeared in the late Middle Ages in Continental Europe.<sup>93</sup> They are specifically mentioned by Malynes<sup>94</sup> and Marius.<sup>95</sup> Both wrote in England, respectively on the Continent and in England, during and with respect to the seventeenth century.

Having complied with the order to pay the bearer, a drawee of a bill payable to bearer appears to discharge liability on the instrument. By the same token,

require that an assignment will be created 'by way of agreement, binding the conscience of the assignor.' *Tailby v Official Receiver* (1888) 13 A.C. 523 at 546. No formality is required.

<sup>86</sup> BEA, above n 6, s 89(1).

<sup>87</sup> See eg *Carlos v Fancourt*, above n 27. In general for eighteenth-century developments, see Holden, above n 9 at 99–144.

<sup>88</sup> Text around n 26 above.

<sup>89</sup> A point that is unfortunately often lost. See eg *Range v Belvédère Finance Corp* [1969] S.C.R. 492, (1969) 5 D.L.R. (3d) 257, where, with regard to an instrument purporting to be a note, Pigeon J posed the question (at 498 (S.C.R.), 261 (D.L.R.)) as to whether it 'is truly a "bill of exchange"'.

<sup>90</sup> See BEA, above n 6, s 89(2), under which, in applying to notes BEA provisions are applicable to bills, 'the maker of a note shall be deemed to correspond with the acceptor of a bill, and the first indorser of a note shall be deemed to correspond with the drawer of an accepted bill payable to drawer's order.'

<sup>91</sup> For bearer clauses in Ancient Mesopotamia, see ch 3, section 2, text around nn 33–44 above.

<sup>92</sup> See ch 6, section 3.1 as well as ch 7, section 2.2 and section 3 above.

<sup>93</sup> See ch 8, text at nn 55 and 81 as well as throughout section 5.

<sup>94</sup> Malynes, above n 31 at 72–73 and 270.

<sup>95</sup> Marius, above n 42 at 13–14.

having performed the promise to pay the bearer, a maker of a note payable to bearer appears to discharge liability on the instrument. The bearer is defined to mean ‘the person in possession of a bill or note which is payable to bearer.’<sup>96</sup> That is, payment to the one who brings or presents the instrument upon its maturity, is a good discharge. This suggests that such instruments freely circulate; it is only logical, then, to equip their bearer with the right to sue and give discharge, as indeed it is under modern law.<sup>97</sup>

Historically, however, it was not all that simple; the road to the transferability by negotiation of bills and notes payable to bearer was rather bumpy. As already pointed out, the dust settled on this issue much later than on the negotiation of bills and notes payable to order.<sup>98</sup> Obviously, then, a bearer clause has not always been taken to mean what it is taken to mean today; rather, and as in fact already pointed out,<sup>99</sup> elsewhere, it had given the payer the liberty to pay to an authorized agent of the promisee/payee<sup>100</sup> upon the presentment of the instrument to the former by the latter on maturity. As such, bearer clauses were abbreviations of clause-making instruments payable to the creditor or ‘his attorney bearing the writing’ known in England from the late thirteenth century.<sup>101</sup> It is with the invention and increased use of goldsmith notes payable to the bearer, in the late seventeenth and early eighteenth centuries, that the ‘abbreviated’ bearer clause had commenced to be understood in its present meaning, as facilitating an easy method for transferring the claim embodied in the instrument, so as to entitle the bearer to sue on it.

Neither Malynes<sup>102</sup> nor Marius<sup>103</sup> sheds much light on the meaning of the bearer clause. Thus, having acknowledged the Continental use as well as even sale of ‘bills obligatory’, namely promissory notes, payable to bearer, Malynes was chagrined by the absence of such a practice in England.<sup>104</sup> At the same time he makes a stern warning<sup>105</sup> not to ‘make a Bill of Exchange payable to the bearer or bringer thereof (as [in] Bills Obligatory beyond the Seas) to avoid the

<sup>96</sup> This is the present definition under BEA s 2, above n 6. It is in conformity with the meaning of the term as understood prior to, as well as outside, the BEA.

<sup>97</sup> The rights to sue and give discharge are accorded to the holder by BEA, *ibid*, ss 38(1) and 59(1) respectively. Under BEA s 2, the holder is either the bearer of an instrument payable to the bearer, or the named payee or endorsee of a bill while in possession of it.

<sup>98</sup> For bills payable to order, see ch 9, text and n 280 above. For notes payable to order, see above, section 3.

<sup>99</sup> See particularly ch 8, n 312 and text around it.

<sup>100</sup> In fact, the promisee did not have to be stated as the payee of the instrument; rather, it could be the original bearer to whom the instrument payable to bearer was issued.

<sup>101</sup> See eg: *Brun St Mitchel v Troner* (1275) reprinted in (1888) 2 Selden Soc. 152; *Curteis v Geoffrey de St Romain* (1287) reprinted in (1908) 23 Selden Soc. 26; *Abingdon v Martin* (1293) reprinted in (1908) 23 Selden Soc. 65; and *Hoppman v Richard of Welborne* (1302) reprinted in (1908) 23 Selden Soc. 86.

<sup>102</sup> Above n 31.

<sup>103</sup> Above n 42.

<sup>104</sup> Malynes, above n 31 at 72–73.

<sup>105</sup> I agree with Holden, above n 9 at 39, that Malynes’ language, in the form of a ‘commandment’ not to use bearer clause in a bill of exchange (‘Neither may you make a Bill of Exchange payable to the bearer’), is to be read as advice and not as a testimony that no such practice existed.

inconveniency which might happen in derogation of the nobleness of the said Bill of Exchange which every Merchant is to maintain.<sup>106</sup> However, he does not elaborate.<sup>107</sup> Also, limiting his comments to a warning against the use of the bearer clause Marius is more specific, pointing out that a bill of exchange payable to bearer may fall, accidentally or by fraud, into the wrong hands so that it may be collected by an unscrupulous person without the intended original bearer ever finding out about it. In Marius' view, a non-fraudulent, even negligent, drawee who pays the bearer is released.<sup>108</sup> However, neither Malynes nor Marius discusses the entitlement of the bearer, whether the original or subsequent, either to recover on the instrument or to keep it notwithstanding an adverse claim to it.

The following is an outline of how the bearer clause acquired its present meaning in English law. It is in line with the discussion of both Holden<sup>109</sup> and Rogers,<sup>110</sup> whose perspectives are separated by only a narrow gap. As anticipated, Holden must be taken to be driven by his adherence to a 'law merchant' as a body of law,<sup>111</sup> which presumably must have been understood as conferring 'negotiability', even in the full sense,<sup>112</sup> on instruments payable to bearer. As such, he is more puzzled by, and demonstrates less acceptance of, the unsmooth judicial process leading to what he must have conceived as an obvious, if not 'pre-determined', conclusion.<sup>113</sup>

Interestingly, we have no discussion in English cases as to what a bearer clause had meant; rather, what we see is a gradual recognition of its new meaning, as conferring on the bearer the power to sue (and give discharge) on the instrument. Thus, a bearer clause appears as early as *Burton v Davy* (1437);<sup>114</sup> however, as discussed,<sup>115</sup> the case does not support at all the transferability by negotiation of the bill of exchange containing that clause. On the contrary, the bearer was likely to be an attorney or agent for collection for the promisee's principal, who was the actual plaintiff, and in whose favour judgment was given, on the basis of the underlying transaction itself. In fact, there is no discussion in the course of the judgment as to the meaning of the bearer clause.

The bearer clause did not fare much better in the late seventeenth century when it was considered in several cases, some of which involved bills while others involved notes. All such cases involved an action by the bearer against a party liable on the instrument. Some instruments were payable to bearer while

<sup>106</sup> Malynes, above n 31 at 270.

<sup>107</sup> Indeed, as pointed out by Holden, above n 9 at 39, text and fn 7, his reasoning 'is, unfortunately, very vague.'

<sup>108</sup> Marius, above n 42 at 13–14.

<sup>109</sup> Holden, above n 9 at 23–25, 59–61, 74–79, 81–82, 114–18.

<sup>110</sup> Rogers, *Bills and Notes*, above n 33 at 46–47, 173–77.

<sup>111</sup> See above, ch 9, section 4, as well as section 3 of this chapter.

<sup>112</sup> That is, in both its 'procedural' and 'material' sense, as set out in section 1 above.

<sup>113</sup> As discussed in ch 9, section 4, as well as section 3 of this chapter.

<sup>114</sup> 49 Selden Society 3, *Select Cases Concerning the Law Merchant* (H Hall (ed), London: Bernard Quaritch, 1932) at 117.

<sup>115</sup> The case is discussed at length at the beginning of ch 9, section 4 above.

others were payable to a named payee or bearer. With the exception of *Shelden v Hentley* (1681),<sup>116</sup> dealing with a bearer's action on a sealed note payable to bearer, none succeeded, albeit on varying considerations.

*Hinton's Case* (1682)<sup>117</sup> involved a bill payable to JS or bearer. In a brief judgment, Pemberton CJ ruled that a bearer seeking to recover from the drawer ought to 'intitle himself to it on a valuable consideration . . . for if he come to be bearer by casualty or knavery, he shall not have the benefit of it.'<sup>118</sup> This, however, does not sound like a rejection of the transferability by delivery, namely, of procedural negotiability, of the bill payable to bearer;<sup>119</sup> rather, this sounds more like a reference to material negotiability, namely, to the conditions that are to be satisfied by a bearer seeking to acquire ownership from a non-owner. In fact, the ruling in *Hinton's Case* did not contradict *Shelden v Hentley* (1681),<sup>120</sup> where an effective delivery to the plaintiff, hence his good title, was averred.

Also, the subsequent case of *Hodges v Steward* (1692)<sup>121</sup> involved an action on a bill payable to JS or bearer. In support of his action against the drawer, the plaintiff-bearer cited a special custom in London; he was successful, but only because the defendant failed to traverse the custom. However, the court was of the opinion that 'a bill payable to J.S. or bearer is not assignable by the contract so as to enable the indorsee to bring an action.'<sup>122</sup> Presumably, the option of transferability of an instrument by mere delivery, that is, without an endorsement, did not even occur to the court.

No similar ambiguity or indecisiveness existed with respect to notes payable to bearer. *Shelden v Hentley* (1681)<sup>123</sup> was left on the sideline, with all subsequent late seventeenth/early eighteenth-century bearer note cases declining to accord the bearer a cause of action. Thus, *Horton v Coggs* (1689)<sup>124</sup> ultimately dismissed the bearer's action against 'the drawer of the note', namely its maker, stating that 'this custom to pay to the bearer was too general.'<sup>125</sup> In *Nicholson v Sedgwick* (1698)<sup>126</sup> the court was prepared to go as far as to recognize the right of an endorsee of a note payable to order 'to bring the action in his own name' against the maker;<sup>127</sup> and yet the court was unprepared to recognize a similar right for the bearer of a note payable to bearer. In the latter case, that of a note payable to bearer, the court reasoned, there is no endorsement indicating 'assent', namely, a voluntary transfer of the instrument; thus, 'if the bearer be

<sup>116</sup> 2 Show. K.B. 160, 89 E.R. 860.

<sup>117</sup> 2 Show. K.B. 235, 89 E.R. 911.

<sup>118</sup> *Ibid* at 236 (Show. K.B.), 911 (E.R.). Grammatically, the 'it' may refer either to the bill or the action.

<sup>119</sup> For the two types of negotiability see section 1, text and n 4.

<sup>120</sup> Above n 116.

<sup>121</sup> Above n 18.

<sup>122</sup> *Ibid*.

<sup>123</sup> Above n 116.

<sup>124</sup> 3 Lev. 299, 83 E.R. 698 (on a motion in arrest of judgment reported in 3 Lev. 296, 83 E.R. 697).

<sup>125</sup> *Ibid* at 299 (Lev.), 699 (E.R.).

<sup>126</sup> 1 Ld. Raym. 180, 91 E.R. 1016.

<sup>127</sup> *Ibid* at 181 (Ld. Raym.), 1016 (E.R.).

allowed to bring the action in his own name, it may be very inconvenient; for then any one, who finds the note by accident, may bring the action.<sup>128</sup>

In fact, it was premature in *Nicholson v Sedgwick* (1698) to state that the endorsee has a right to bring an action in his own name; *Clerke v Martin* (1702),<sup>129</sup> precluding even the payee's action on a note payable to order 'upon the custom of merchants', is certainly to the contrary.<sup>130</sup> In any event, counsel in the latter case, who argued that a note payable to order was 'negotiable', conceded that a note payable to bearer 'is not assignable nor indorseable by the intent of the subscriber, and consequently not negotiable'.<sup>131</sup>

The issue was ultimately resolved only during the second half of the eighteenth century, in *Grant v Vaughan* (1764).<sup>132</sup> This was an action by a bona fide purchaser of a cheque<sup>133</sup> payable to bearer against its drawer. Having taken the precaution of satisfying himself with the creditworthiness of the drawer and the genuineness of the instrument, the plaintiff received the cheque in good faith from a person in possession of it, possibly the finder, against goods and some change delivered by the plaintiff to that person. In upholding the plaintiff's action against the drawer, Lord Mansfield thought that the reasons that had been given in *Nicholson v Sedgwick* (1698)<sup>134</sup> 'were insufficient'.<sup>135</sup> Having found that the goldsmith/banker would have never paid other than upon the production of the instrument to him, Lord Mansfield could not see any downside to holding for the bearer.<sup>136</sup> He went on to explain *Hinton's Case* (1682),<sup>137</sup> a case dealing with a bill payable to bearer, to say 'that the [bearer's] action would lie, if [he] came by the bill of exchange honestly and on a valuable consideration'.<sup>138</sup> He further noted the convergence between bills and notes, as reflected in the *Promissory Notes Act*, 1704.<sup>139</sup>

In fact, the *Promissory Notes Act* is not directly relevant.<sup>140</sup> As recalled, the principal objective of the Act was to make notes payable to order governed by rules of law governing inland bills of exchange. This covers rules as to negotiation,

<sup>128</sup> *Ibid.*

<sup>129</sup> Above n 34.

<sup>130</sup> For an extensive discussion see section 3 above.

<sup>131</sup> Above n 34 at 757–58 (Ld. Raym.), 6 (E.R.).

<sup>132</sup> 3 Burr. 1516, 97 E.R. 957.

<sup>133</sup> The report speaks of a 'cash-note'. Rogers, *Bills and Notes*, above n 33 at 177 speaks of a 'note', arguably as a mere abbreviation of 'cash-note'. Holden, above n 9 at 216 speaks of a 'cheque' (or 'bill drawn upon a banker'); however, presumably, as discussed in section 5 below, taking the cheque to be a sub-category of the bill of exchange, he also refers to the instrument as a 'bill of exchange' (*ibid* at 116). The 'cash-note' appears to be what we call today a 'cheque' and is so treated in the present discussion.

<sup>134</sup> Above n 126.

<sup>135</sup> Above n 132 at 1522 (Burr.), 960 (E.R.).

<sup>136</sup> *Ibid.*

<sup>137</sup> Above n 117 and see discussion around it.

<sup>138</sup> Above n 132 at 1521 (Burr.), 959 (E.R.). This indeed is implied by the judgment. *Ibid.*

<sup>139</sup> Above n 50.

<sup>140</sup> Notwithstanding a modern suggestion to the contrary, by D Fox, 'Bona Fide Purchase and the Currency of Money' (1996), 55 *Cambridge Law Journal* 547 at 562, as to the possible relevance of the statute to the protection of the bona fide purchaser of a note payable to bearer.



and yet, only insofar as they apply to bills of exchange payable to order;<sup>141</sup> particularly, it has to be recalled, the negotiation by mere delivery of bills had not yet been settled by the passage of the *Promissory Notes Act*.<sup>142</sup> Indeed, the Act specifically provides, in section 1, that a note payable to ‘order, or unto bearer . . . shall be taken and construed to be . . . due and payable to any such person’; at the same time, the provision goes on to state that every note payable ‘to any person . . . or . . . order shall be assignable or indorsable over’, without mentioning at all the transferability of a note payable to bearer. Accordingly, section 2, speaking of the right to maintain an action for the sum payable on the note, appears to refer to an instrument payable to order.

However, in the final analysis, *Grant v Vaughan* (1764)<sup>143</sup> was overdue. As will be seen below in section 6.2 of this chapter, already before the close of the seventeenth century, common law protected the property right of a bona fide purchaser for value of an instrument payable to bearer.<sup>144</sup> For his part, having already established in *Miller v Race* (1758)<sup>145</sup> the title of a bona fide purchaser for value of a lost or stolen note payable to bearer, Lord Mansfield was effectively bound not to reach in *Grant v Vaughan* (1764) any other decision but to allow the bearer to recover. In relying on the obvious implication from *Hinton’s Case* (1682),<sup>146</sup> Lord Mansfield was absolutely right; it is incongruous to protect the bearer’s property right in Conversion<sup>147</sup> and yet not allow him to sue for the sum payable on the instrument.

In my view, the torturous way of recognizing the negotiation by delivery of the instrument payable to bearer reinforces the position, stated in section 2 of this chapter, that the endorsement had not been looked upon as a method of transfer, but rather, as the issue of a new bill of exchange. Had it been seen as a method of transfer of an instrument payable to order, constituted by delivery and signature, it would have been easier to conceive of the instrument payable to bearer as transferable by delivery alone, without signature. At the same time, it was conceptually impossible to treat the mere delivery of an instrument payable to bearer, unaccompanied by any signature, as the issue of a new bill. Therefore, courts ultimately were ‘forced’ to recognize the transferability by delivery of an instrument payable to bearer. What nevertheless might have led to this was the realization that the treatment of the endorsement completed by delivery of an instrument payable to order as the issue of a new bill was a mere fiction, a means to an end. In practice, such endorsement completed by delivery

<sup>141</sup> See this chapter, section 3, text and nn 49–50.

<sup>142</sup> As discussed in the first part of this section above.

<sup>143</sup> Above n 132.

<sup>144</sup> *Anon* (1699) 3 Salk. 71, 91 E.R. 698.

<sup>145</sup> 1 Burr. 452 at 457, 97 E.R. 398 at 401 (K.B.), discussed above in ch 10, section 3.2, text and n 128, as well below as in this chapter, section 6.2 below.

<sup>146</sup> Above n 117.

<sup>147</sup> For the action on the case for Trover and Conversion, from which the tort of Conversion, as misappropriation of property, is derived, and for its effective ‘takeover’ of Detinue, see CHS Fifoot, *History and Sources of the Common Law: Tort and Contract*, (London: Stevens & Sons, 1949) at 102–25 (hereafter: Fifoot, *History*).

facilitated a transfer of the instrument; hence, it became impossible to resist the extension of a similar effect to the physical transfer, albeit unaccompanied by signature, of an instrument payable to the bearer. Indeed, any resistance to such extension, whatever might have been its basis, was bound to fail in the face of the increased reliance on the bearer clause by issuers of paper designed to circulate.<sup>148</sup>

## 5. NEGOTIATION OF CHEQUES

Under section 73 of the *Bills of Exchange Act*, '[a] cheque is a bill of exchange drawn on a banker payable on demand.' In principle, the provision further states, 'the provisions of this Act applicable to a bill of exchange payable on demand apply to a cheque.' Hence, it might be expected that the negotiation of cheques would have been recognized under the same rules and principles facilitating the negotiation of bills. This, indeed, is the conclusion of Holdsworth; in his view, '[t]here is no doubt that, from the first, the order given by a customer to the banker to pay was regarded as a bill of exchange, and therefore negotiable.'<sup>149</sup> Holden is in full agreement on this point;<sup>150</sup> in his view, 'cheques . . . were simply bills of exchange drawn upon a person carrying on a particular profession and payable on demand.'<sup>151</sup> Richards' argument is not far off; while he endeavours to trace the cheque to an earlier demand note drawn on the Exchequer,<sup>152</sup> a point on which he is rebutted by Holden,<sup>153</sup> he is of the opinion that '[u]nder the Law Merchant, cheques also, it would appear, were regarded from the outset as bills of exchange.'<sup>154</sup>

At the same time, judicial recognition in the transfer by negotiation of cheques came late, and not without hesitation.<sup>155</sup> In fact, it coincided with the ultimate recognition in the transfer by negotiation of a bill or note payable to bearer;<sup>156</sup> thus, *Grant v Vaughan* (1764)<sup>157</sup> held that a 'cash-note' drawn upon a banker, namely a cheque, payable to a named payee or bearer, is 'by law, negotiable.'<sup>158</sup> As well, *Boehm v Sterling* (1797)<sup>159</sup> was an action brought 'upon a bill of exchange'<sup>160</sup> to enforce payment on a cheque payable to the bearer. It was, however, argued in that case that in contrast to the note, the cheque is not con-

<sup>148</sup> A point specifically made by Rogers, *Bills and Notes*, above n 33 at 177.

<sup>149</sup> Holdsworth, above n 37 at 190.

<sup>150</sup> Holden, above n 9 at 219.

<sup>151</sup> Holden, *ibid* at 208.

<sup>152</sup> Richards, above n 33 at 52–64.

<sup>153</sup> Holden, above n 9 at 207–08.

<sup>154</sup> Richards, above n 33 at 49.

<sup>155</sup> For a review of the process, see Holden, above n 9 at 215–19.

<sup>156</sup> See discussion in text at nn 132–39.

<sup>157</sup> Above n 132.

<sup>158</sup> *Ibid* at 1523 (Burr.), 961 (E.R.).

<sup>159</sup> 7 T.R. 423, 101 E.R. 1055.

<sup>160</sup> *Ibid* at 423 (T.R.), 1056 (E.R.).

sidered negotiable, so that 'whoever receives it in payment takes it on the credit of the person giving it and not on the intrinsic credit of the instrument itself.'<sup>161</sup> In the final analysis in that case, to Lord Kenyon, this proposition 'appear[ed] most extraordinary',<sup>162</sup> and he dismissed it outright. Similarly, albeit only as late as in the middle of the nineteenth century, *Serle v Norton* (1841)<sup>163</sup> did not question the right of a non-payee holder of a cheque payable to the order to sue the drawer.<sup>164</sup>

Transferability by negotiation of a cheque was finally confirmed, albeit not without being first challenged, in *Keene v Beard* (1860).<sup>165</sup> In the course of his judgment, Byles J pointed out two unique features of a cheque which distinguish it from an ordinary bill of exchange. To begin with, in his view, a cheque appropriates drawer's funds held by the drawee.<sup>166</sup> On this point he was subsequently overruled, first by case law<sup>167</sup> and then by statute.<sup>168</sup> Second, a cheque 'is not discharged by delay in the presentment, unless . . . he has been prejudiced thereby.'<sup>169</sup> On this point his ruling was subsequently codified.<sup>170</sup> However, otherwise, Byles J was of the view that a cheque 'has . . . all the incidents of an ordinary bill of exchange';<sup>171</sup> as such it 'falls within the class of ordinary bills of exchange'.<sup>172</sup>

What remains curious in this chain of event is the existence of lingering doubts as to the transfer by negotiation of cheques all the way until the beginning of the second half of the nineteenth century, close to the passage of the *Bills of Exchange Act*. Stated otherwise, since the endorsement of bills of exchange goes back to the seventeenth century,<sup>173</sup> why did it take 200 years to confirm the transfer by negotiation of cheques, particularly if, as claimed, they are truly bills of exchange?

Fifoot attributes the delay to 'the conservatism of the law' during the first half of the nineteenth century, reopening a gap 'between law and commerce', and expressed in judges' obsession 'with the doctrine of privity of contract which had

<sup>161</sup> *Ibid* at 428 (T.R.), 1058 (E.R.).

<sup>162</sup> *Ibid* at 430 (T.R.), 1059 (E.R.).

<sup>163</sup> 2 M. & Rob. 401, 174 E.R. 331.

<sup>164</sup> Unfortunately, the Report contains a 'somewhat irrelevant and certainly inaccurate footnote' to the contrary. See Holden, above n 9 at 218.

<sup>165</sup> 8 C.B. (N.S.) 372, 141 E.R. 1210.

<sup>166</sup> *Ibid* at 381 (C.B.), 1213 (E.R.).

<sup>167</sup> *Hopkinson v Forster* (1874) L.R. 19 Eq. 74 at 76, per Jessel MR.

<sup>168</sup> BEA, above n 6, s 53(1), providing, other than for Scotland, that '[a] bill, of itself, does not operate as an assignment of funds in the hands of the drawee available for the payment thereof, and the drawee of a bill who does not accept as required by this Act is not liable on the instrument.' The section applies to all bills, including cheques. It rules out the application of the Continental *la provision*, discussed above, in ch 8, text and nn 178, 215–19, and 313–16. See also above, in ch 9, text and nn 341–49.

<sup>169</sup> Above n 165 at 381 (C.B.), 1213 (E.R.).

<sup>170</sup> BEA, above n 6, s 74.

<sup>171</sup> *Ibid* at 381 (C.B.), 1213 (E.R.).

<sup>172</sup> *Ibid* at 381 (C.B.), 1214 (E.R.).

<sup>173</sup> See above, ch 8, text and nn 249–54 as well as section 4.2 of this chapter above.

proved a stumbling-block in an earlier age.<sup>174</sup> In his view, judges treated the payment of the cheque as deriving from the contract between the banker and his customer. As such it was in effect argued that the cheque was 'merely a matter of convenience between banker and customer.'<sup>175</sup> The inevitable conclusion unfortunately was that 'no one but the parties to the original contract should be permitted to sue on it.'<sup>176</sup>

It should however be noted that if cheques were truly considered bills of exchange it would have been unlikely for such doubts to occur. Rather, I submit, the simple reason for the slow recognition in the negotiability of cheques is that it is an anachronism to treat the cheque as a species of a bill. Rather, historically, the emergence and original evolution of the cheque had nothing to do with the bill of exchange, and hence, to contemporaries, it was not all that obvious as to why, how, and even if at all, these two instruments would be subject to the same rules.

As discussed, the Continental cheque system evolved out of the Continental book-transfer system.<sup>177</sup> Thus, in its pristine form, in Venice, the Medieval banking book transfer required the presence and consent of all three parties, namely, debtor-payer, creditor-payee, and paymaster-banker. For its part, the presence-of-all-three requirement, and hence the lack of reliance on a written instruction, was bound to eliminate fraud. The requirement was not a source of inconvenience, because usually all three were situated in the same vicinity and the banker tended to keep his books available on his desk. However, on occasion, the debtor was ill and thus inhibited from coming to the banker. It is on such rare occasions that written payment orders started to be used. Gradually, however, already throughout the fourteenth and fifteenth centuries, written payment orders spread and became common, first in Italy, outside Venice, particularly in Tuscany, including Florence, and then elsewhere outside Italy. Initially, '[w]ritten instruments could be used . . . only as supplementary memoranda or as instruments appointing an agent.'<sup>178</sup> When they became payment orders whose presentment to the banker by one party dispensed with the presence of the other, their function was to generate either a cash payment or a book transfer.

Possibly some of such payment orders were in effect cheques, each issued by the payer/debtor to the payee/creditor, instructing the banker to pay to the payee/creditor, as well as authorizing the payee/creditor to collect from the banker. It is in this process that a Medieval cheque system was born. However, Medieval cheques were not negotiable, usually even non-transferable; possibly

<sup>174</sup> CHS Fifoot, 'The Development of the Law of Negotiable Instruments and of the Law of Trusts' (1938), 59 *Journal of the Institute of Bankers* 433 at 450–51.

<sup>175</sup> This is how he conceptualized the argument, set out 'at great length and with an alarming display of erudite, if obsolete, learning' in *Keene v Beard*, above n 165. Fifoot, *ibid* at 451.

<sup>176</sup> Fifoot, *ibid* at 451.

<sup>177</sup> See above, ch 8 text and nn 44–56.

<sup>178</sup> Usher, above n 3 at 283.

other than in specific times and places they were not widely used.<sup>179</sup> The Medieval cheque initiated either a payment in cash or a book transfer; either way the cheque accomplished 'the transfer of the creditor's right against the banker to a third party'<sup>180</sup> and thus did not generate a legal perspective of its own.

To a limited extent, cheques were used by the money changers in Amsterdam. However, their development in the Netherlands was arrested with the establishment of the Bank of Amsterdam (the Wisselbank) in 1609, whose operations superseded, to a large extent, those of the money changers. It is however quite possible that cheques were 'imported' to London directly from Amsterdam.

Indeed, it is reported that in Amsterdam cheques were endorsable.<sup>181</sup> Similarly, early cheque specimens, from the second half of the seventeenth century in England, are payable to the order or to the bearer,<sup>182</sup> and hence appear to be transferable by negotiation. However, so far as I can tell, at least in the English sources, during the seventeenth century, there is no evidence for a practice of the negotiation of cheques. To a large extent, this is not surprising; cheques were invented as payment mechanisms, pure and simple; they were designed to transmit funds from a debtor to a creditor and were not credit instruments. As well, compared to the banknote, the cheque was inferior as a substitute for money, as it did not carry a banker's obligation.<sup>183</sup> Hence, there was no business reason to make the cheque transferable; the 'order' or 'bearer' language that cheques used might have been a mere coincidence.<sup>184</sup>

However, during the late seventeenth century, side by side with the evolution of cheques, bills of exchange transformed and became negotiable.<sup>185</sup> At some point it became apparent that both bills and cheques were orders, and that they operated as payment mechanisms, so that the cheque appeared to fall into the definition of the bill as if it were a special category of bill. It is this realization, coupled with the fact that the law of bills of exchange had been developing at a quickening pace while in fact there was no 'ready-made' law for cheques, that triggered both isolated cases of cheque negotiation and the legal conclusion

<sup>179</sup> See in general, R De Roover, 'New Interpretations of the History of Banking' in J Kirshner (ed), *Business, Banking, and Economic Thought in Late Medieval and Early Modern Europe: Selected Studies of Raymond de Roover* (Chicago and London: University of Chicago Press, 1974, Phoenix Edition 1976) at 216–17; as well as Usher, *ibid* at 90–94. For an extensive discussion, see M Spallanzani, 'A Note on Florentine Banking in the Renaissance: Orders of Payment and Cheques' (1978), 7:1 *Journal of European Economic History* 145.

<sup>180</sup> Usher, *ibid* at 91, referring in the quoted language to the depositor-drawer as 'creditor' (of the bank) and to his own (the 'creditor'-depositor-drawer's) creditor, namely to the payee, as the 'third party'.

<sup>181</sup> See above, ch 8 text and nn 54–56.

<sup>182</sup> See eg Holden, above n 9 at 210 and Richards, above n 33 at 51–52.

<sup>183</sup> See above, ch 10, text at nn 57–60.

<sup>184</sup> Another enigma is why no book-transfer system, not using cheques, was developed by the goldsmiths, whose operation in the City of London, as in Medieval Venice, was confined to a small territory. I suppose that with the introduction of cheques in London, there was simply no need for such a face-to-face system.

<sup>185</sup> See above, ch 8 text and nn 249–54.

that since cheques fall under the definition of bills they are governed by the same rules and hence are transferred by negotiation.

Nevertheless, in the final analysis, as pointed out, cheques had not evolved out of bills of exchange. The classification of the cheque as a bill, and the convergence between the legal features of these instruments, is thus a historical accident. It was only after the 'formative period' that the deposit of the cheque became treated as 'negotiation', albeit not without a relaxation in the endorsement requirements,<sup>186</sup> so as to accord the bank of deposit a defence-free position towards the drawer.<sup>187</sup> At the same time, Continental legislation appeared to recognize the distinction between cheques and bills in covering them in separate statutes; this, however, turned out to be mainly a matter of form, since substantive provisions governing bills and cheques are quite similar. Particularly, under Continental legislation,<sup>188</sup> as under its English counterpart,<sup>189</sup> bills and cheques payable to order are transferred by endorsement. On the other hand, at present, both Continental legislation<sup>190</sup> and, even more so, the English statute,<sup>191</sup> allow for the non-transferable cheque, which indeed, may better reflect the typical intention of the drawer.<sup>192</sup>

It may well be that, during the seventeenth to the nineteenth centuries, contemporaries were more aware of the distinction between cheques and bills. This may have given rise to resistance to the automatic application to the former of rules governing the latter. In fact, contemporaries could not be blamed for being cognizant of the obvious, namely, that typically the drawer does not envisage the circulation of his cheque; that is, he does not intend it to be negotiated. Indeed, the holder of an instrument payable on demand can get its face value by immediately presenting it for payment; such a holder does not benefit from the 'discounting' practice. An instrument payable on demand circulates only when its intrinsic value, namely the obligation on it, is as good as cash. This is the case for the banknote but not the cheque.

<sup>186</sup> *Cheque Act, 1957 (U.K.)*, 5 & 6 Eliz. 2, c. 36, s. 2.

<sup>187</sup> Exercising rights of a holder in due course under BEA, above n 6, s 38(2), on the basis of compliance with BEA ss 27(3) (holder's lien as value) and 29(1) (holding in due course requirements).

<sup>188</sup> Article 11 of the *Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes*, 7 June 1930, 143 L.N.T.S. 257, Annex I (transfer by the endorsement of a bill of exchange) (hereafter: Bill Convention, or ULB) and art 14 of the *Convention Providing a Uniform Law for Cheques*, 19 March 1931, 143 L.N.T.S. 355, Annex I (transfer by the endorsement of a cheque) (hereafter: Cheque Convention, or ULC).

<sup>189</sup> BEA, above n 6, s 31.

<sup>190</sup> Article 14 of the Cheque Convention, above n 188, allows a cheque to be drawn 'not to order' in which case it 'can only be transferred according to the form and with the effects of an ordinary assignment.' For 'non-transferable' cheques in Italy and for standard cheque forms in France indicating they are endorsable only to banks see B Geva, *Bank Collections and Payment Transactions: Comparative Study of Legal Aspects* (Oxford: Oxford University Press, 2001) at 185 (hereafter: Geva, *Bank Collections*).

<sup>191</sup> BEA, above n 6, s 81A. Thereunder, the properly marked cheque 'shall not be transferable, but shall only be valid between the parties thereto.' In not allowing even the assignment under general law, this provision goes beyond the corresponding provision in the Geneva Cheque Convention, *ibid.*

<sup>192</sup> In the contemporary environment, other than the bank of deposit, the cheque cashing service is the only business which systematically takes cheques by endorsement.

Ultimately, however, form overcame substance; cheques merged into a category, albeit with some distinct features, of bills. As such, cheques became fully transferable by negotiation.

Certainly, ramifications of this ‘merger’ are beyond ‘negotiability’. Thus, as indicated at the beginning of this subsection, per section 73 of the *Bills of Exchange Act*, ‘[a] cheque is a bill of exchange drawn on a banker payable on demand’; in principle, the provision further states, ‘the provisions of this Act applicable to a bill of exchange payable on demand apply to a cheque.’ The separate statutory regime in the Continent does not change the essence of this result, since much of the Cheque Convention duplicates those applicable to bills of exchange payable on demand under the Bills Convention. A detailed comparison is beyond the scope of the present discussion; suffice it to point out the existence of convergence between English and Continental provisions with respect to cheques, as well as by comparison with bills of exchange, on fundamental matters, such as drawer’s liability,<sup>193</sup> endorser’s liability,<sup>194</sup> lack of cause of action of the payee-holder against the drawee,<sup>195</sup> and signer’s liability triggered by dishonour upon presentment.<sup>196</sup>

## 6. NEGOTIATION AND MATERIAL NEGOTIABILITY: CIRCULATION FREE FROM CLAIMS AND DEFENCES

### 6.1 Introduction

As pointed out in section 1 above, the legal doctrine facilitating paper circulation is known as ‘negotiability.’ As indicated before, for example, in chapter eight, section 5 above, a ‘negotiable instrument’ is a document of title to a sum of money, transferable by delivery (either with or without an endorsement), and capable to confer title to it free of a third party’s adverse claims and prior parties’ defences.<sup>197</sup> Under modern English law, ‘negotiation’ is the definitive method of transfer of a negotiable instrument,<sup>198</sup> facilitating circulation, namely, the transfer to the new holder of all the benefits of ‘negotiability’.<sup>199</sup> The

<sup>193</sup> BEA, above n 6, s 55(1); ULC, above n 188, art 12; and ULB, above n 188, art 9.

<sup>194</sup> BEA, *ibid* s 55(2); ULC, *ibid* art 18; and ULB, *ibid* art 15.

<sup>195</sup> BEA, *ibid* s 53. No exact parallel exists under the ULB and ULC, *ibid*. The latter precludes altogether the acceptance of cheques (ULC art 4). Cheque certification, under which the cheque drawee becomes liable to the holder, is available in some common law as well as civil law jurisdictions, but will not be discussed here. For an overview, see Geva, *Bank Collections*, above n 190 at 133 (in general), 143–44 (jurisdictions that adopted a statute modeled on the BEA), 161–62 (US), and 182–83 (jurisdiction with a statute modelled on the ULC).

<sup>196</sup> BEA, *ibid* s 55; ULC, *ibid* art 40; and ULB, *ibid* arts 34 and 43.

<sup>197</sup> Cowen and Gering, above n 4 at 52.

<sup>198</sup> BEA, above n 6, s 31.

<sup>199</sup> BEA, *ibid* ss 29(1) and 38(2).



negotiation of a bill of exchange payable to the order requires, in addition to the physical delivery of the bill, its endorsement by the transferor.<sup>200</sup>

'Negotiability' consists then of two elements. First, it signifies transferability by delivery (with or without endorsement), which is referred to as 'transferability with a certain facility' or 'procedural negotiability'. Second, 'negotiability' addresses the transferor's power to thereby confer on the transferee a better title than that of the transferor; this is referred to as 'transferability free from equities' or 'material negotiability'.<sup>201</sup>

The holder who is not the direct promisee on the instrument, namely, usually<sup>202</sup> either an endorsee of an instrument payable to order or a 'remote' bearer of an instrument payable to bearer, may benefit from each of the two elements of 'negotiability' in a different way. Thus, it is 'procedural negotiability' which confers on the holder the right to sue, that is, the standing to bring an action, on the instrument he holds. In turn, it is however 'material negotiability' which usually<sup>203</sup> guarantees to the holder the right to recover from a party liable on the instrument the full amount thereon. 'Material negotiability' thus complements 'procedural negotiability'.

Two points are noteworthy. First, 'procedural negotiability' did not originate in English law. Earlier in this study, we already encountered its traces in Mesopotamia,<sup>204</sup> its development under the Talmud,<sup>205</sup> and its operation under Islamic legal doctrine.<sup>206</sup> At the same time, as was already demonstrated in this chapter,<sup>207</sup> its evolution in English law appeared to be independent, and uniquely premised on viewing the endorsement of an instrument as a new bill of exchange.

Second, 'material negotiability' has not sprung automatically out of 'procedural negotiability'. In fact, in the early legal systems that accommodated 'procedural negotiability', that is, negotiation, there is no indication of the existence of 'material negotiability', that is, the ability to acquire a better title. Stated otherwise, the emergence of 'material negotiability' as an effect of negotiation, namely, of 'procedural negotiability', is an improvement that is owed to developments in English law. Conceptually, however, as a rule, while 'material

<sup>200</sup> BEA, *ibid* s 31(3). Requirements for 'indorsement' are set out in BEA, *ibid* s 33. See also definition in s 3. For 'indorse' and 'endorse' see n 9 above.

<sup>201</sup> See Cowen and Gering, above n 4 at 31–36.

<sup>202</sup> There are 'unusual' circumstances, as eg of a bank draft issued to a remitter to the order of his creditor, in which the payee is not an 'immediate' party to a transaction with the party who issued the instrument. Such circumstances are outside of the scope of the present discussion.

<sup>203</sup> Certainly, there is a narrow range of defences, based on the ineffectiveness altogether of the instrument, which are available even against a holder in due course. Such defences are outside of the scope of the present discussion.

<sup>204</sup> For the transferable 'promissory note' in Old Babylonia and the gap in our knowledge as to the law applicable to the transfer, see ch 3, section 2, text around nn 33–44.

<sup>205</sup> See ch 7, section 2.1, text and nn 61–75.

<sup>206</sup> See ch 6, particularly section 3.1, text around nn 117–28; section 3.2; section 3.3, text around nn 190–201; and section 4, text and nn 238–48.

<sup>207</sup> See sections 2 and 3 above.

negotiability' cannot exist without 'procedural negotiability',<sup>208</sup> the reverse is not true, so that 'procedural negotiability' can exist on its own, without generating 'material negotiability'.

The difference between the two elements of negotiability can be demonstrated by reference to *Hinton's Case* (1682),<sup>209</sup> discussed earlier in this chapter.<sup>210</sup> The case involved a bill payable to JS or bearer. In his judgment, Pemberton CJ ruled that a bearer seeking to recover from the drawer of that bill, ought to 'intitle himself to it on a valuable consideration . . . for if he come to be bearer by casualty or knavery, he shall not have the benefit of it.'<sup>211</sup> As further discussed in this chapter,<sup>212</sup> in *Grant v Vaughan* (1764),<sup>213</sup> Lord Mansfield understood Pemberton CJ to say in *Hinton's Case* (1682) 'that the [bearer's] action would lie, if [he] came by the bill of exchange honestly and on a valuable consideration.'<sup>214</sup> It appears, then, that Lord Mansfield did not deny the impact of 'procedural negotiability', namely, the standing of the bearer to sue on the instrument, even when he came 'to be bearer by casualty or knavery'; nevertheless, to succeed in his action, Lord Mansfield would require the bearer to rely on 'material negotiability', that is, on the fact that he 'came by the bill of exchange honestly and on a valuable consideration.'

The preceding sections of this chapter set out the evolution of the first feature in English law, that of 'procedural negotiability'. The present section will discuss the evolution under English law of the second feature, that of 'material negotiability'. Each of the following subsections will set out the development of one of the two components of 'material negotiability'. The first aspect is the holder's freedom from a third party's adverse claims to the instrument. The second is the holder's freedom from contract defences of a party liable on it. The cumulative effect of both freedoms is the enforceability by the holder of the instrument of the entire amount payable, over both challenges to his proprietary right to the instrument, and contract defences purporting to extinguish or reduce the liability of a party thereto.

## 6.2 Freedom from Adverse Claims

According to Fox,<sup>215</sup> as a legal attribute:

Currency allows the title in money to be renewed whenever the money passes to a person who receives it in good faith and in return for a valuable consideration. The

<sup>208</sup> Albeit, this rule proved not to be absolute; particularly during the first half of the twentieth century in the US and Canada, a waiver of defence clause in a sale contract was used to insulate an assignee from defences arising from the sale. See Geva, *Financing*, above n 80 at 93–101.

<sup>209</sup> Above n 117.

<sup>210</sup> Text at nn 117–20.

<sup>211</sup> Above n 117 at 236 (Show. K.B.), 911 (E.R.). Grammatically, the 'it' may refer either to the bill or the action.

<sup>212</sup> Text at n 138.

<sup>213</sup> Above n 132.

<sup>214</sup> *Ibid* at 1521 (Burr.), 959 (E.R.).

<sup>215</sup> Above n 140 at 547.

recipient's title is freshly created. It is good against the whole world, which means that the recipient can acquire a better title than the transferor had.

Stated otherwise, the effect of the currency feature of money, which may also be referred to as the currency rule, is to confer on the bona fide for value payee a good title, and extinguish adverse property claims such as prior ownership. Thus, having been out of possession of money, whether by losing it or being the victim of robbery or theft, the owner's title is defeated by a good faith taker for value who derives his title from the finder or thief. Another way to put it is to say that the maxim *nemo dat quod non habet* does not apply to money, so that the finder or thief can confer on the taker in good faith and for value a better title than that of the finder or thief.

The first aspect of 'material negotiability' corresponds to 'currency'. A leading case is *Anon* (1699),<sup>216</sup> which involved a 'bank bill'<sup>217</sup> payable to a payee or bearer. The instrument was lost by the payee; it was found by a stranger, who 'assigned it', that is, delivered it, to the plaintiff-bearer 'upon a valuable consideration'. The plaintiff presented the instrument and received payment from the bank in the form of 'a new bill in his own name'. In a terse judgment, Lord Holt concisely set out the relative rights of the parties to the original instrument. In his view, on the facts of the case, the payee:

may have trover against the finder, for [the finder] had no title, though a payment to him had indemnified the bank; but not against [the assignee/bearer] *because of the consideration, which, by course of trade, creates a property in the assignee or bearer.* (Emphasis added.)<sup>218</sup>

Subsequently, more than 50 years later, the point was confirmed by Lord Mansfield in *Miller v Race* (1758).<sup>219</sup> This was an action in Trover<sup>220</sup> by a bona fide purchaser for value of a stolen Bank of England note payable to bearer. The defendant was the Bank of England's clerk who had acted on the instructions of the dispossessed original owner<sup>221</sup> and upon the presentment of the note for payment had refused to either honour or return the note to the plaintiff. Effectively, the court was called upon to determine the relative rights of the plaintiff and the dispossessed original owner, from whom the defendant had purported to derive his right. In ruling in favour of the plaintiff, Lord Mansfield recognized the effect of the plaintiff's good faith purchase for value to extinguish the property right of the dispossessed original owner. In the course of his

<sup>216</sup> Above n 144.

<sup>217</sup> According to Fox, above n 140 at 560, this was a 'sealed Bank of England bill'. However, Holden, above n 9 at 91 describes the instrument as 'a Bank of England note'.

<sup>218</sup> Above n 144 at 71 (Salk.), 698 (E.R.).

<sup>219</sup> Above n 145.

<sup>220</sup> For Trover and Conversion, see reference in n 147 above.

<sup>221</sup> More specifically, the original owner sent the banknote by post. However, that night the post office was burgled and the banknote was taken and carried away by the burglar. The plaintiff bought it the next day 'for a full and valuable consideration, and in the usual course and way of his business, and without any notice or knowledge of this bank note being taken out of the mail.' Above n 145 at 452 (Burr.), 398 (E.R.).

judgment, Lord Mansfield explained the nature of bearer Bank of England notes as follows:

Now they are not goods, not securities, nor documents for debts, nor are so esteemed: but are treated as money, as cash, in the ordinary course and transaction of business, by the general consent of mankind; which gives them the credit and currency of money, to all intents and purposes. They are as much money, as guineas themselves are; or any other current coin, that is used in common payments, as money or cash.<sup>222</sup>

In Lord Mansfield's view, the treatment of banknotes as money was the determinative factor. It is their 'monetary' feature which allowed the plaintiff to recover to the detriment of the dispossessed original owner; the latter's rights had been simply extinguished. This is so since:

money can not be followed . . . upon account of the currency of it: it can not be recovered after it has passed in currency. So, in case of money stolen, the true owner can not recover it, after it has been paid away fairly and honestly upon a valuable and bona fide consideration: but before money has passed in currency, an action may be brought for the money itself.<sup>223</sup>

An obiter dictum of Lord Holt in *Ford v Hopkins* (1700)<sup>224</sup> is cited by Fox<sup>225</sup> in support of the contrary position in relation to banknotes. Indeed, in that case, Lord Holt spoke of the difference between, on one hand, 'money or cash' that cannot be distinguished and, on the other hand, banknotes; the latter, having 'distinct marks and numbers on them', are distinguishable.<sup>226</sup> Certainly, this appears to be inconsistent with Lord Holt's own view in *Anon* (1699).<sup>227</sup> Fox explains away the apparent contradiction between the two cases by suggesting that, between them, only *Ford v Hopkins* (1700) involved banknotes, and that Lord Holt did not treat notes as negotiable.<sup>228</sup> However, as already pointed out, it is possible, and it is in fact so argued by Holden,<sup>229</sup> that *Anon* (1699) too, upholding 'negotiability', involved a banknote.<sup>230</sup> Moreover, as discussed at length in section 3 above, Lord Holt challenged the negotiability of notes, possibly other than banknotes, and certainly, only where they were payable to order; there is no indication of a challenge by him to the negotiability of banknotes, or notes in general, payable to bearer. Hence, it does not seem to be correct to explain *Ford v Hopkins* (1700) as premised on the denial of negotiability from the banknote payable to bearer with which the case was concerned.

<sup>222</sup> *Ibid* at 457 (Burr.), 401 (E.R.).

<sup>223</sup> *Ibid* at 457–58 (Burr.), 401 (E.R.).

<sup>224</sup> 1 Salk 283, 91 E.R. 250.

<sup>225</sup> Fox, above n 140 at 561.

<sup>226</sup> Above n 224 at 284 (Salk.), 251 (E.R.).

<sup>227</sup> Above n 144, and see discussion there setting out Lord Holt's view.

<sup>228</sup> Fox, above n 140 at 561–62.

<sup>229</sup> Holden, above n 9 at 91.

<sup>230</sup> See n 217 above.

What then is the explanation for *Ford v Hopkins* (1700)?<sup>231</sup> In his judgment in *Miller v Race* (1758) Lord Mansfield expressed the view that Lord Holt must have been misunderstood so that his judgment in *Ford v Hopkins* (1700) was not correctly reported.<sup>232</sup> Nevertheless, there may be a simpler explanation to the apparent contradiction; it could be that in *Ford v Hopkins* (1700) Lord Holt pointed out a physical difference between coins and banknotes but did not address the position of a bona fide purchaser of value thereof. However, in the final analysis, as explained below, it is likely that in distinguishing – in *Ford v Hopkins* (1700) – between coins and banknotes, Lord Holt purported to point at the physical dissimilarity between them not on its own, but rather as underlying the inadequacy of the traditional explanation to the currency of money. It is this physical dissimilarity which necessitates a search for the reconceptualization of the currency feature so as to cover not only coins but also banknotes.

Thus, in the case of loss or theft of coins, the lack of distinguishing marks in them does not facilitate their following into the hands of a third party; at the same time, it is precisely the existence of distinguishing marks in banknotes that facilitates their following into the hands of a third party. However, notwithstanding the broad language in *Ford v Hopkins* (1700), stating that the owner of stolen or lost banknotes may ‘bring an action into whatsoever hands they are come’, and that banknotes ‘cannot be reckoned as cash’,<sup>233</sup> this distinction between coins and banknotes matters only insofar as the third party does not qualify as an innocent purchaser for value. Indeed, it was observed in *Hartop v Hoare* (1743)<sup>234</sup> that this broad language by Lord Holt must be narrowed down to ‘mean, that the owner can bring an action for them, into whatsoever hands they come without a *valuable consideration* paid for them’ (emphasis in original).<sup>235</sup> Conversely, where the third party in possession of banknotes qualifies as a good faith purchaser for value, notwithstanding the broad language in *Ford v Hopkins* (1700), per Lord Holt’s own statement in *Anon* (1699), the currency quality confers title on the third party, also to banknotes; this is so ‘because of the consideration, which, by course of trade, creates a property in the [innocent] assignee or bearer.’<sup>236</sup>

In *Miller v Race* (1758), in providing for the currency of money, Lord Mansfield was dismissive of the view under which ‘the reason why money can not be followed is, because it has no ear-mark.’<sup>237</sup> It seems, however, and notwithstanding Lord Mansfield to the contrary, lack of earmark appears to be the original explanation of the currency of coined money in English law.<sup>238</sup> Unlike Jewish law, English law did not develop a legal doctrine explaining the currency

<sup>231</sup> Above n 224.

<sup>232</sup> Above n 145 at 459 (Burr.), 402 (E.R.).

<sup>233</sup> Above n 224 at 284 (Salk.), 251 (E.R.).

<sup>234</sup> 3 Atk. 44, 26 E.R. 828.

<sup>235</sup> *Ibid* at 50 (Atk.), (E.R.) 832.

<sup>236</sup> *Anon* (1699), above n 144 at 71 (Salk.), 698 (E.R.).

<sup>237</sup> Above n 145 at 457 (Burr.), 401 (E.R.).

<sup>238</sup> Fox, above n 140 at 549–54.

of coins.<sup>239</sup> Rather, prior to *Miller v Race* (1758), lost or stolen coins passed from hand to hand free of claims of the previous owners simply because they lacked identifying signs, or distinct marks or numbers.

In fact, there is no case law specifically using the lack of earmark to explain the currency of coins. Rather, lack of earmark, in the sense of a distinguishing mark, was used to explain why Detinue was unavailable as action for the recovery of money. Specific identification was strictly required if only because an action in Detinue ‘affirms always property’ in the plaintiff,<sup>240</sup> so that, if in Detinue, the defendant had the option of returning the detained chattel rather than paying its value.<sup>241</sup> However, for its part, identification required distinguishing marks that were not available for individual coins.

Indeed, money enclosed in a chest, bag or other receptacle, so as not to be used as current coin,<sup>242</sup> was recoverable in Detinue.<sup>243</sup> In such a case, the recoverable object was not a sum of money, but the container enclosing the money. Such a ‘box under seal’, rather than the sum of money, was sufficiently identifiable so as to be conceived as the specific chattel to be recovered in Detinue.<sup>244</sup> Stated otherwise, Detinue was available ‘to recover the thing it self’; conversely, ‘in a detinue for money delivered, if it be out of a bag, the action lyeth not, because that no certain property can then be known.’<sup>245</sup>

Similarly, it was held in *Higgs v Holiday* (1599)<sup>246</sup> that when a buyer pays the price of goods to the seller’s servant, ‘[t]he property of the money was never<sup>247</sup> in the master [namely, the seller], but in the servant’. This was rationalized as an application of the general rule under which ‘if a man delivers money to another, the property thereof is in the bailee, because it cannot be known.’ Accordingly, the servant who declines to remit the proceeds to the master has not appropriated them, and is liable to him in account, but not Trover.<sup>248</sup>

However, subsequently the House of Lords reasoned in *Foley v Hill* (1848) that money received from the buyer of goods by an agent acting for the seller, ‘remains the property of the principal’, namely the seller.<sup>249</sup> In this light, the

<sup>239</sup> For ‘currency’ under the Talmud, see ch 2, section 2.4 above.

<sup>240</sup> *Bishop v Viscountess Montague* (1601) Cro. Eliz. 824, 78 E.R. 1051.

<sup>241</sup> See Fox, above n 140 at 550. Accordingly, a ‘bailee of a horse who kill[ed] it by overwork’ could meet an action in detinue by returning its ‘decayed corpse’. Cf AW Simpson, ‘The Introduction of the Action on the Case for Conversion’ (1959), 75 *LQR* 364 at 368 dealing with the availability of trover and conversion in that case.

<sup>242</sup> For this qualification, see *Anon* (1619) 3 Leon. 38, 74 E.R. 526, under which Detinue does not lie for money ‘sealed up in a bag’ given to the bailee to buy goods for the bailor.

<sup>243</sup> See eg *Sir George Walgrace’s Case* (1687) Noy. 12, 74 E.R. 983.

<sup>244</sup> *Luffenham v Abbot of Westminster* (1313) Y.B. Hil. 6 Ed. II, reprinted in (1926), 43 *Selden Soc.* 65. See Fifoot, *History*, above n 147 at 27–28.

<sup>245</sup> *Isaack v Clark* (1615) 2 Bust. 306 at 308, 80 E.R. 1143 at 1145.

<sup>246</sup> Cro. Eliz. 746, 78 E.R. 978.

<sup>247</sup> ‘Never’ may be an overstatement; under a more refined analysis, the master had the property in the coins only promptly to lose it for inability to identify them. See below discussion at the end of the paragraph that immediately follows.

<sup>248</sup> *Higgs v Holiday*, above n 246. For the bailee’s rights under the bailment of money see above, ch 9, section 3.

<sup>249</sup> 2 H.L.C. 28 at 35, 9 E.R. 1002 at 1005.

agent's right to the money paid to him by the buyer can be explained under *Higgs v Holiday* (1599)<sup>249,1</sup> on the agent's right 'to appropriate it, . . . making himself a debtor to the [principal]'.<sup>250</sup> For its part, this right is premised on the fact that a claim to specific monetary objects (whether coins or banknotes) can be raised by the principal/master<sup>251</sup> only as long as they can be distinguished; if not individually, then at least by the 'container' or bank account into which they are segregated.<sup>252</sup> In other words, money in the common law 'could be followed . . . provided it could be earmarked or traced into assets acquired with it'<sup>253</sup> or, more generally, 'the thing produced ought to follow the nature of the thing out of which it is produced,'<sup>254</sup> [only] if it can be distinguished'.<sup>255</sup>

In short, property follows possession 'where the true owner hath no marks to ascertain his property, as in money' other than when it is segregated;<sup>256</sup> it is practically impossible to follow coined money into the hands of another, and it does not matter whether this other person is an innocent purchaser for value, a finder, or even a thief. Hence, since an individual coin lacks a distinguishing feature, it is not only the bona fide purchaser for value in possession of coined money who defeats the property right of a prior owner; consequently, no independent currency rule developed for coined money.

However, the monetary landscape changed with the introduction of paper money. As was recognized by Lord Holt in *Ford v Hopkins* (1700),<sup>257</sup> each individual banknote bears a number or otherwise may have a distinctive mark. Indeed, in cases decided as of the eighteenth (if not late seventeenth) century<sup>258</sup> with regard to the right to follow money, judges must have already envisaged banknotes. However, they were faced with the reality that usually people do not take notice of distinguishing features of individual banknotes; in the normal

<sup>249,1</sup> Above note 246.

<sup>250</sup> CC Langdell, 'A Brief Survey of Equity Jurisdiction' (1889), 2 *Harvard Law Review* 241 at 245.

<sup>251</sup> For the treatment of a factor (of a principal) as a servant (of a master) so as to justify similar rules to issues discussed here, see eg OW Holmes, 'The History of Agency' in AALS, *Select Essays in Anglo-American Legal History* (Boston: Little, Brown, & Co, 1909) vol 3 at 368 (first published in 1891, 4 *Harvard Law Review* 345 and in 1891, 5 *Harvard Law Review* 1).

<sup>252</sup> Strictly speaking, money in a bank account is a misnomer; rather, once deposited with a bank, depositor's money becomes the property of the bank, and is replaced, in the depositor's hands, with a debt claim against the bank. *Foley v Hill*, above n 249. Thus, the money is followed into the debt owed by the bank. In the sense of the quoted language which immediately follows, the debt then becomes an 'earmarked' asset acquired with the money.

<sup>253</sup> *Sinclair v Brougham* [1914] AC 398 (H.L.) at 420.

<sup>254</sup> However, with the view of accommodating commercial expediency, more recently, some courts consciously abandoned strict identification in favour of 'close and substantial connection'. Cf *Agricultural Credit Corp of Saskatchewan v Pettyjohn* [1991] 3 W.W.R. 689 (Sask. CA) at para 51, dealing with tracing one herd into the proceeds of a second herd bought with money realized from the sale of the first herd.

<sup>255</sup> *Scott v Surman* (1743) Willes 400 at 404, 125 E.R. 1235 at 1238, specifically in relation to the debt owed by the buyer for the price of the goods that being 'distinguishable' belong to the principal/master (original owner) and not the agent/servant (who sold the good on the owner's behalf).

<sup>256</sup> *Hartop v Hoare* (1743), above n 234 at 50 (Atk.), 832 (E.R.).

<sup>257</sup> Above n 224.

<sup>258</sup> Including *Isaack v Clark* (1615), above n 245; *Hartop v Hoare* (1743), above n 234; *Scott v Surman* (1743), above n 255; and *Foley v Hill* (1848), above n 249.



course of business they do not record numbers of banknotes but rather treat them as fungible. Such treatment by people is not sloppy; it is essential for the smooth operation of payment transactions and the flow of commerce. Practically then, most people would not be able to identify banknotes, given or taken, whether voluntarily or involuntarily, out of their possession. From this perspective, there is no difference in the treatment by people of coins and banknotes, so that for most cases the law regarding the right to follow money remained unchanged; after all, there is no difference between no earmark and an earmark that has not been noted.

However, legal doctrine had to take into account the possibility that in some cases people may take advantage of the innovation introduced by banknotes and record the identification numbers of banknotes held in their possession. Certainly, then, such banknotes may be identified in the hands of a third party and hence, under contemporary legal doctrine, may have been followed and claimed by an owner who had lost or been dispossessed of them. It is at this point that a currency rule, as an exception to the right to follow, had to be formulated. More generally, the importance of the currency quality of money, taken for granted before now, came to be recognized as a feature supporting circulation and hence liquidity so as to facilitate a smooth flow of commerce.<sup>259</sup> As such, if it were to equally apply to all forms of money, a new uniform rationale had to be formulated.

It was to that end that, in the footsteps of Lord Holt in *Anon* (1699), Lord Mansfield in *Miller v Race* (1758)<sup>260</sup> formulated a new comprehensive theory for currency, based on the inherent nature of money, and thus applicable to whatever constitutes money, either by law or societal consensus, as may be evidenced by the treatment given to it by merchants. Arguably, it was with a view to eliminating any possible distinction between the application of the currency features to coins and banknotes that Lord Mansfield went as far as to defy history and dismiss altogether the 'earmark' premise, until then responsible for bypassing the need to formulate a currency rule. Historical truth was thus sacrificed in order to secure a cohesive doctrinal basis for the future. At the same time, it was exactly that 'earmark premise' which Lord Holt highlighted in *Ford v Hopkins* (1700);<sup>261</sup> having until then underlied the currency of coins and in effect precluded their tracing in the hands of *any* third party, this premise became inadequate to explain the currency of banknotes, so as to necessitate the formulation of a new comprehensive doctrine. That doctrine would supersede the 'earmark premise' and cover all types of money, and yet be limited to the protection of an *innocent* third party *for value*.

It is to this challenge that Lord Mansfield stood up in *Miller v Race* (1758) in protecting the good faith taker of a banknote.<sup>262</sup> Arguably, then, according to

<sup>259</sup> For money facilitating liquidity and flow of commerce, see in general ch 1, section 2 and ch 2, section 1 above.

<sup>260</sup> Above nn 144 and 145 respectively.

<sup>261</sup> Above n 224.

<sup>262</sup> Above n 145.

Lord Mansfield's formulation, the currency feature is attributed to all monetary objects in order to enable their use to best implement, as circulating media, the function of money. Once banknotes had come to be used as money they became automatically governed by this rule. As it was broadly stated, the currency rule turned out to be flexible enough to be able to subsequently cover also 'bank money', in the form of credit to a bank account,<sup>263</sup> as a means of payment. Thus, while not interfering with the following of money into a segregated bank account,<sup>264</sup> as well as with tracing money into an account where it is mixed with other funds,<sup>265</sup> the currency rule effectively afforded protection to a bona fide payee for value out of such accounts.<sup>266</sup>

Rogers is, however, sceptical of this understanding of Lord Mansfield's decision and hence of the conventional rationale for the currency rule. He starts by acknowledging that:

The usual explanation for the [currency] rule is that it would impede the utility of money if a good faith taker were subject to remote claims, for then people would be less willing to accept money as payment without making inquiries about its provenance.<sup>267</sup>

However, he goes on to say that 'the argument seems rather implausible. One suspects that people's inclination to accept money has a great deal more to do with the upside potential than the downside risks.' They 'routinely accept paper money without any investigation' even though banknotes may be either stolen or counterfeit.<sup>268</sup>

Accordingly, Rogers endeavours to interpret Lord Mansfield's dismissal of the 'money has no ear-mark' rationale as relating to money in the sense of an abstract unit of account rather than consisting of monetary objects. However, in my view, this is unconvincing, not to mention anachronistic. It is unconvincing because it is not the abstract unit of account but rather 'bank money', in the form of credit to a bank account, which moves over the non-cash payment systems. It is also anachronistic; true, as just pointed out,<sup>269</sup> the currency feature applies to 'bank money', so as to exempt a bona fide purchaser<sup>270</sup> for value from

<sup>263</sup> For 'bank money' as 'funds' or credit to a bank account see eg ch 1, concluding paragraph of section 2 above. See also ch 10, section 5 above.

<sup>264</sup> For this right, see eg *Taylor v Plumer* (1815) 3 M. & S. 562 at 575, 105 E.R. 721 at 726.

<sup>265</sup> For this right, see eg *Re Hallett's Estate* (1880) 13 Ch. D. 696 (C.A.).

<sup>266</sup> Cf *General Motors Acceptance Corp of Canada Ltd v Bank of Nova Scotia* (1986) 55 O.R. (2d) 438 (C.A.) where, albeit without specifically mentioning the currency rule, the court effectively applied it in disallowing tracing into amounts withdrawn in the ordinary course of business from a bank account.

<sup>267</sup> JS Rogers, 'Negotiability, Property, and Identity' (1990–91), 12 *Cardozo Law Review* 471 at 501 (hereafter: Rogers, Negotiability). The ensuing discussion purports to present Rogers' view as expounded in this article. See also earlier articles by him, 'Negotiability as a System of Title Recognition' (1987), 48 *Ohio State Law Journal* 197; and 'The Myth of Negotiability' (1989–90), 31 *Boston College Law Review* 265.

<sup>268</sup> Rogers, Negotiability, *ibid* at 501.

<sup>269</sup> See text at n 263 above.

<sup>270</sup> In this context, 'purchaser' is used loosely to include 'receiver' or 'payee' as well.

a tracing claim to that money. As well, there is no 'earmark' to any unit of 'bank money'. However, 'bank money' was not widespread in Lord Mansfield's era. Regardless, the plain meaning of Lord Mansfield's text suggests a reference to monetary objects, namely, coins and banknotes, and not to 'abstract units of account' transferable in modern 'electronic funds transfer systems'.<sup>271</sup>

For his part, Rogers purports to explain the currency of monetary objects on the intention of parties involved, whether one who delivers money for whatever purpose, the recipient of money, or one who is to obtain it out of commingled funds. Due to the fungibility of money, such a person does not care about the individuality of any banknote. Indeed, this reasoning does not extend to apply the currency rule to a bailor of money who, in a given case, may be concerned with the solvency of the bailee. As well, it does not apply to one who identifies lost or stolen money in the hands of a third party other than a bona fide purchaser for value.<sup>272</sup> Nor does it cover even 'bank money' that can be traced in equity other than in the hands of a bona fide purchaser for value.<sup>273</sup> Certainly it does not cover the case of a person who, other than in payment for value received, delivered banknotes whose numbers he deliberately recorded. In all such cases an owner may succeed to recover, other than against a bona fide purchaser of value, bailed, stolen, misappropriated or lost money even if not segregated, by simply identifying individual banknotes, or at least, tracing the money.

I understand Rogers' rationale to support this conclusion for all such cases; however, his rationale does not seem to capture the reason that the bona fide purchaser for value, and no one else, would nevertheless prevail over the owner who took all these precautions. For example, his reasoning does not explain why a bona fide purchaser for value, and only a bona fide purchaser for value, will prevail over a bailor betrayed by the bailee, over banknotes specifically identified by the bailor to be segregated and safely kept by the bailee, who nevertheless paid with them, and which were received by the bona fide purchaser for value.

True, in suing someone in possession of banknotes, a former possessor is likely to be satisfied upon receiving the amount claimed rather than necessarily the very banknotes that form the subject matter of the litigation. Certainly, against a thief or finder, the former possessor needs only prove the theft or finding (and the amount) of the money; he will win even if he proves this otherwise than by identifying the specific banknotes in the defendant's possession. However, identification of the banknotes is likely to be an easy way to prove his claim even against such a defendant. Moreover, against a third party who received the banknotes from the thief or finder, positive identification of the banknotes is required; once it happens, the only third party to oust the former possessor is the bona fide purchaser for value. Moreover, there are circumstances

<sup>271</sup> Rogers, 'Negotiability', above n 267 at 504.

<sup>272</sup> Cf *Taylor v Plumer*, above n 264, dealing with securities and bullion as proceeds of money paid to honour a draft.

<sup>273</sup> See text at n 266 above.

where positive identification of banknotes, with the view of setting a proprietary right thereto, is necessary in order to succeed on a claim for their entire amount. This is the case of a claim by an owner out of possession against an insolvent defendant, including a thief or finder.<sup>274</sup> Hence, identification of banknotes, rare as it is, has practical implications not ignored by law.

In observing that risks of stolen or counterfeit monetary objects are usually ignored by people, Rogers appears to be only partly right. His observation is correct only for an environment in which there is confidence in the genuineness of circulating currency,<sup>275</sup> and only for relatively small cash payments.<sup>276</sup> Otherwise, Rogers' observation is an overstatement. As explained below, human behaviour is more complex and its implications do not deny the rationale of the currency feature of money as a lubricant for the smooth flow of commerce.

Thus, the risk of counterfeit banknotes is reduced by enhanced security features in banknotes and credible law enforcement; in any given situation, the greater the risk of circulating counterfeit banknotes, the lower the confidence in the currency system, and the greater the precautions taken by receivers of banknotes.<sup>277</sup> In fact, when a word comes out as to the circulation of counterfeit banknotes of a specific denomination or other common description, it is not uncommon to see signs posted by retailers indicating their refusal to receive banknotes of that denomination or description. As well, in large cash transactions it is not uncommon for payees to take precautions designed to ensure that banknotes they take are genuine.<sup>278</sup> Finally, where the wrongdoer is not available to cover the loss, protection for the taker of a counterfeit banknote is politically unfeasible; this is so since, other than if an insurance scheme is devised, protection can be implemented only by allocating the loss to the purported currency issuer. This is likely to happen only where the purported currency issuer deems it necessary to cover such losses in order to protect the integrity of its currency system.<sup>279</sup>

Certainly, a receiver of money, including 'bank money', can endeavour to verify the provenance of funds paid by his payer. However, such attempts may be onerous and unsuccessful; and certainly, they will slow down the circulation of money. As well, no precautions can be taken against receipt of stolen banknotes other than the verification of each number (or other identification mark it bears) against a data base. Technologically such verification is more feasible nowadays than in those of Lord Mansfield; and while, per Rogers' observations, payees of

<sup>274</sup> Otherwise, the former possessor is left with a claim for a dividend in the insolvency proceedings.

<sup>275</sup> Conversely, he is probably right even where there is an abundance of lawlessness generating circulation of a great number of stolen banknotes, precisely because of the currency rule.

<sup>276</sup> What is a small or a large amount may be in the eye of the beholder, and may vary for different eras; no attempt will be made to draw a fixed distinction.

<sup>277</sup> An extreme situation (certainly in a failing country) is where people accept only banknotes certified by reputed moneychangers to be genuine.

<sup>278</sup> Such precautions may include the use of sophisticated equipment.

<sup>279</sup> Cf eg *Banco de Portugal v Waterlow and Sons, Ltd* [1932] A.C. 452 (H.L.), extensively discussed in ch 10, section 4 above.

small amounts may bypass this verification and take the risk, this is not necessarily so for takers of large amounts. Overall, then, commercial transactions would have slowed down in the absence of a currency rule.

At its inception, as pronounced by Lord Mansfield, the currency feature concerned monetary objects. In the final analysis, 'currency' is designed to secure circulation of money so as to accord the bona fide purchaser for value protection. Protection to be accorded to him is exactly in those cases where an earlier owner can identify monetary objects or trace 'bank money' received by the purchaser. Indeed, intention may be manifested to exclude the currency rule, for example, when banknotes are delivered in a sealed bag for safekeeping; and yet, even in such a case, the currency rule will apply to protect the bona fide purchaser for value of such banknotes. Intention and practice of parties, in usually overlooking number and identification marks of individual banknotes, is relevant to explain the paucity of cases involving the currency rule and yet it does not explain the rule itself. Moreover, unlike banknotes and coins, 'bank money' can easily be followed and traced; hence the increased importance of the currency rule even as a practical matter.

A remaining issue is the extension of the currency rule, that is, the first element of 'material negotiability', to bills of exchange, cheques and promissory notes that do not serve strictly as 'money'. The question became obscured by the policy to treat all such instruments uniformly as 'negotiable instruments'; in part, this policy was premised on the view that negotiable instruments actually circulate so as to 'form part of the currency of the country'.<sup>280</sup>

However, the extension of 'negotiability', in the sense of freedom from adverse claims, to instruments other than banknotes, had at least one major 'collateral benefit'. This was the enhancement of the discounting and circulation of bills of exchange payable to order<sup>281</sup> on which the expansion of banking became partly dependent.<sup>282</sup> For example, suppose the owner-holder of a bill of exchange payable to order endorsed it and delivered it to an intermediary either by way of pledge for a loan or for safekeeping. The intermediary however betrayed the owner (the previous holder); he discounted the bill of exchange with a bank and misappropriated the proceeds. In this case, as long as the discounting bank (being a purchaser for value) acted in good faith, the effect of negotiability was to protect it from the adverse claim of the defrauded owner.<sup>283</sup> Certainly, in facilitating smooth circulation, this result enhanced the benefit of the discounting practice.

However, in the context of nineteenth-century England, the effect of the doctrine of negotiability to defeat adverse claims has not been all that exceptional. Thus, with the view of facilitating the free flow of goods in commerce, in the course of the nineteenth century, English common law protected a buyer of

<sup>280</sup> Cf *Foster v Mackinnon* (1869) 20 L.T. 887 at 889.

<sup>281</sup> See eg Holden, above n 9 at 294–98.

<sup>282</sup> See section 1 above.

<sup>283</sup> See eg *London Joint Stock Bank v Simmons* [1892] A.C. 201.

goods from a seller who had a voidable title thereto.<sup>284</sup> This was subsequently codified.<sup>285</sup> As well, statutory law came to provide for the protection of buyers who claimed title to goods they acquired from non-owners in lawful possession of such goods.<sup>286</sup> Protection has thus been provided to a bona fide buyer of goods as against:

- (i) the owner, where the buyer bought the goods from the owner's mercantile agent, who was in possession of the goods, and who sold the goods in breach of the owner's authority;<sup>287</sup>
- (ii) an earlier buyer, where the (subsequent) buyer (to be protected) bought the goods from the seller (to both buyers) who had sold the goods to the earlier buyer but remained in the possession of the goods;<sup>288</sup> and
- (iii) the seller to an earlier buyer where the (subsequent) buyer (to be protected) bought the goods from the earlier buyer who had taken possession but had not acquired title yet.<sup>289</sup>

True, negotiability provides broader protection for instruments than these rules for goods; as well, negotiability is a common law doctrine while, with the one exception of the buyer from a seller who had voidable title to the goods, these rules are statutory, and are contrary to common law.<sup>290</sup> At the same time, particularly once negotiability has also been codified, these developments in the law of sale of goods foreshadowed negotiability and put it in a broader context of rules facilitating commerce by protecting a bona fide purchaser from an owner in lawful possession.<sup>291</sup>

Indeed, in the absence of 'negotiability', protection from adverse claims would have been partial. The common law treatment of the purchaser in possession of a certificate relating to a registered share, who took it, for value and in good faith, bearing a blank endorsement by the registered shareholder, is a case in point. Under the common law, such a share certificate is not negotiable. Nevertheless, in *Colonial Bank v Cady* (1890),<sup>292</sup> the bona fide purchaser for value in possession of a registered share certificate endorsed in blank, who derived his title from the original registered shareholder, was protected from adverse claims. For example, such an adverse claim could be asserted by an earlier buyer from the owner who had not taken possession of the certificate. Alternatively, an adverse claim could be

<sup>284</sup> See eg *Cundy v Lindsay* (1878) 3 A.C. 459 at 464.

<sup>285</sup> *Sale of Goods Act*, 1893 (UK), 56 & 57 Vic., c. 71, s 23.

<sup>286</sup> See eg MD Chalmers, *The Sale of Goods Act*, 1893, 5th edn (London: William Clowes, 1902) at 128–44.

<sup>287</sup> *Factors Act*, 1889 (UK), 52 & 53 Vic., c. 45, s 2(1).

<sup>288</sup> *Sale of Goods Act*, above n 285 s 25(1) (as well as *Factors Act*, *ibid* s 8).

<sup>289</sup> *Sale of Goods Act*, *ibid* s 25(2) (as well as the *Factors Act*, *ibid* s 9).

<sup>290</sup> See Chalmers, above n 286 at 134, 138, 140.

<sup>291</sup> On this trend in general, albeit primarily from the American perspective, see G Gilmore 'The Commercial Doctrine of Good Faith Purchase' (1954), 63 *Yale Law Journal* 1057 (hereafter: Gilmore, Good Faith).

<sup>292</sup> 15 A.C. 267 (H.L.), dealing with acquisition from brokers to whom executors of a deceased shareholder surrendered share certificates endorsed in blank.

asserted by the owner himself where the buyer (to be protected) purchased the share certificate from the owner's agent who had lawful possession but had sold the share certificate in breach of authority.

Conversely, when the bona fide purchaser for value in possession of a share certificate endorsed in blank derived his title from a thief, the purchaser would not have been protected against the dispossessed earlier holder (including the original registered owner). In fact, protection accorded to the bona fide purchaser for value of a share certificate endorsed in blank, being limited to one who takes it from a lawful possessor, is in line with the protection given to a bona fide buyer of goods from a non-owner in lawful possession as under the statutory rules for the sale of goods.<sup>293</sup>

At the same time, a bill or note on which the only or last endorsement is in blank falls into the definition of an instrument payable to bearer.<sup>293.1</sup> In that respect, it is not unlike a registered share certificate endorsed in blank. However, unlike a registered share certificate endorsed in blank, a bill or note payable to bearer is negotiable. Its negotiability protects its purchaser for value and in good faith, also when he took it from a thief or finder; the purchaser's protection is against the adverse claims of the former holder or anyone who purports to derive title from him. Hence, negotiability enhances protection from adverse claims.

However, this advantage cannot be overstated. While extending the benefit of negotiability to bills, notes and cheques, that is, all instruments falling under what had been conceived as 'law merchant', English law did not go all the way; it did not go as far as to allow the free circulation of instruments payable to order over forged endorsements.<sup>294</sup> On this point, Continental law went the other way. Originally it was on the same lines with English law on this point. However, as early as during the course of the eighteenth century, Continental law moved in the opposite direction, allowing the forged endorsement to pass title to an instrument payable to order free of adverse claims of the dispossessed (thus former) holder.<sup>295</sup>

Effectively then, in England, for a bona fide purchaser for value of an instrument payable to order bearing a forged endorsement, 'negotiability' does not improve much, if at all, on the protection accorded by statute to a bona fide buyer of goods from a non-owner in lawful possession. Thus, *Miller v Race*

<sup>293</sup> See text and nn 285–89 above. Cf *Sale of Goods Act*, above n 285, s 21(1) (buyer gets good title to goods sold by non-owner where 'the owner of the goods is by his conduct precluded from denying the seller's authority to sell'). Arguably, one surrendering possession of an instrument endorsed in blank may be so precluded.

<sup>293.1</sup> BEA, above n 6, s 8(3). See also s 34(1) under which 'An indorsement in blank specifies no indorsee, and a bill so indorsed becomes payable to bearer'.

<sup>294</sup> For an overview with regard to cheques see Geva, *Bank Collections*, above n 190 at 422–34 (following which there is a detailed discussion of the allocation of forged endorsement losses in major legal systems).

<sup>295</sup> The point is now codified in the ULB art 16, above n 188 as well as the ULC art 19, *ibid* on which legislation throughout the world is modeled in civil law countries including those in Continental Europe. For a comprehensive historical review see F Kessler, 'Forged Indorsements' (1938), 47 *Yale Law Journal* 863 at 863–71.



(1758)<sup>296</sup> was distinguished and not followed to protect a bona fide purchaser for value of an instrument payable to order claiming through a forged endorsement. Rather, the dispossessed (thus former) owner is to prevail on him. This goes back to *Mead v Young* (1790)<sup>297</sup> where the majority declined to apply the free circulation policy to the case of a forged endorsement; in the case of a theft, this policy thus became limited in English law only to instruments payable to bearer, where no endorsement is required to pass title, as in *Miller v Race* (1758). For instruments payable to order the majority in *Mead v Young* (1790) explicitly highlighted the policy of loss minimization achieved by requiring an endorsee to verify the good title of his endorser. The protection of the property right of the dispossessed owner became a tool for the implementation of this policy.

The rule in *Mead v Young* (1790) is codified both in the English *Bills of Exchange Act*<sup>298</sup> and Article 3 of the American *Uniform Commercial Code*.<sup>299</sup> Thus, in principle,<sup>300</sup> in Anglo-American law, a negotiable instrument payable to order passes from an endorser to an endorsee free of adverse claims only insofar as it bears a genuine endorsement.

In retrospect, it is possible that discounting banks did not require protection from forged endorsement; the protection accorded to them from other adverse claims, as discussed above, may have been adequate to provide the liquidity required for expansion of banking.<sup>301</sup> Indeed, the Anglo-American position as to the effect of forged endorsement has its own logic; in minimizing losses, it may have provided the right balance among all parties participating in the discounting endeavour.<sup>302</sup> However, in the final analysis, in not defeating adverse claims arising from a forged endorsement, under Anglo-American law, negotiability for bills and notes payable to order does not go much further than the statutory rules protecting buyers of goods. It is reasonable to assume that in the absence of 'negotiability', legislation would have been passed to protect bona fide purchasers for value of bills and notes who took them from lawful possessors, as it did for buyers of goods. So far as protection from adverse claims is concerned, with such hypothetical legislation, only a modest role would have been left for negotiability, beyond the provision of currency to banknotes and other bills and notes payable to bearer.

<sup>296</sup> Above n 145.

<sup>297</sup> 4 T.R. 28, 100 E.R. 876, in which an action by an endorsee who derived his title through a forged endorsement against the acceptor of a bill was dismissed.

<sup>298</sup> BEA, above n 6, s 24.

<sup>299</sup> U.C.C., above n 9, §3-403.

<sup>300</sup> For cheques, exceptions are discussed in Geva, *Bank Collections*, above n 190 at 465–87 (for jurisdictions that adopted the BEA, with or without variations) and 501–14 (for Article 3 of the U.C.C. in the US).

<sup>301</sup> See text and nn 281–83 above.

<sup>302</sup> For a general policy discussion on forged endorsement loss allocation, see Geva, *Bank Collections*, above n 190 at 423–31.

### 6.3 Freedom from Contract Defences

Typically, the maker's obligation on a note is on debt he owes the payee. For his part, not necessarily knowing much of the drawer's debt to payee (not to speak of each endorser's debt to his respective endorsee), the acceptor is more likely to be liable on a bill by reference to his own obligation to the drawer. Is the obligation of a maker of a note and that of the acceptor on a bill enforceable free of defences available to the maker against the payee and to the acceptor against the drawer? Indeed, the holder's freedom from contract defences, being the second aspect of material negotiability, enhances circulation.<sup>303</sup> However, does the holder's defence-free position exist, and can it be explained either by the language and form of a negotiable instrument, or by the effect of the good faith acquisition for value of the instrument?

The holder's power to enforce an instrument free from the obligor's defences became a practical issue as the use of negotiable instruments for payment for goods had increased. Compared to a buyer of goods, an issuer of a banknote, but also a borrower of money, is less likely to have and hence raise defences to his liability. Discounted merchants' bills of exchange were issued in connection with transactions for the sale of goods for resale rather than for use; the goods themselves were 'generic' – and thus dissimilar to the complex mechanical products of today. Arguably, then, such transactions were not likely to raise many disputes as to the quality of the goods, and hence to liability to pay for them. Not surprisingly then, during the seventeenth and eighteenth centuries, it was the freedom from adverse claims, and not from contract defences, that was crucial for the circulation of banknotes, notes issued by borrowers, and bills of exchange on which merchants were liable. At the same time, the holder's freedom from contract defences was taken advantage of in the course of the industrial revolution, with the rise of retail credit sales during the nineteenth century, when the use of promissory notes in payment of goods bought for use increased.<sup>304</sup> However, as will be demonstrated, the holder's defence-free position had been confirmed already in the course of the eighteenth century.

As already discussed in an earlier chapter,<sup>305</sup> the defence-free position of the payee towards the drawee with whom he has not dealt appears to be traced to *Baker v Lambert* and *Grelle v Lambert* (1510–13).<sup>306</sup> In that case, according to Beutel, 'a drawee [who was sued] . . . by a payee . . . [did] not offer as a defense that the drawer . . . [had been] indebted to him'.<sup>307</sup> However, this was an exchange

<sup>303</sup> See section 6.1 above.

<sup>304</sup> In this context, eg, for the nineteenth-century development of the promissory note becoming a credit instrument issued by a retail buyer in the US, see G Gilmore, 'Formalism and the Law of Negotiable Instruments' (1979–80), 13 *Creighton Law Review* 441 at 451–53.

<sup>305</sup> Chapter 9, section 5, text around n 325 above.

<sup>306</sup> Reprinted in (1929), 46 *Selden Soc.* 2, *Select Cases Concerning the Law Merchant* (H Hall (ed), London: Bernard Quaritch, 1930) 138.

<sup>307</sup> FK Beutel, 'The Development of Negotiable Instruments in Early English Law' (1938), 51 *Harvard Law Review* 813 at 832, fn 94. The facts as to the drawer's indebtedness to the drawee 'appear in the same case'. *Ibid.*

transaction, so that the drawee was in fact an agent of the drawer and the payee was an agent of the remitter; the payee's action must have been that of the remitter-lender against the drawer-borrower.<sup>308</sup> In such an action, the drawee's defences against his principal, the drawer, are certainly irrelevant. Hence, the case cannot be cited for the broader proposition as to the independent right of the payee against the drawee free of the latter's defences against the drawer.<sup>309</sup>

In any event, in *Baker v Lambert* and *Grelle v Lambert* (1510–13), the drawee did not even accept the bill. At the same time, later, towards the end of the first quarter of the seventeenth century, Malynes confirmed the view that a drawee who accepted a bill could not raise against the payee defences available to him, the drawee, against the drawer.<sup>310</sup> A similar view was expressed by Marius in the middle of the seventeenth century.<sup>311</sup> Both addressed their remarks only in relation to the acceptor's defence based on the insolvency of the drawer.

The payee is not a purchaser of the negotiable instrument. His defence-free position can be rationalized on the autonomy, that is, the abstract or absolute nature, of the obligation on a negotiable instrument. Under this explanation, the absolute nature of the obligation is a function of either the form or language of the instrument, whether the promise of a promissory note or the acceptance of an order on a bill of exchange.<sup>312</sup> Alternatively in the case of a bill, the absolute nature of the drawer's liability is derived from the unconditional language in which his statutory engagement, upon the dishonour of the bill, is expressed.<sup>313</sup>

To that end, an analogy can be drawn between the availability of the obligor's defences in an action on a negotiable instrument and their availability in an action on a document under seal ('specialty contract'). A negotiable instrument, 'quite like . . . a specialty . . . stands apart, complete in itself'.<sup>314</sup> Its effect on the transaction under which it is given<sup>315</sup> is akin to the effect of an undertaking

<sup>308</sup> See ch 9, section 4, discussion in text and nn 202–05 (in connection with *Burton v Davy*) as well as around n 217 above.

<sup>309</sup> Notwithstanding my earlier conclusion to the contrary in Geva, *Financing*, above n 80 at 84, which is hereby repudiated.

<sup>310</sup> Malynes, above n 31 at 274. See Holden, above n 9 at 41–42. See also Holdsworth, above n 37 at 157.

<sup>311</sup> Marius, above n 42 at 20. See Holden, above n 9 at 47.

<sup>312</sup> To be negotiable, a bill of exchange must contain an unconditional order and a promissory note must contain an unconditional promise. At present, this is codified by BEA, above n 6, ss 3(1) (for a bill) and 83(1) (for a note). A classic authority is *Carlos v Fancourt* (1794) 5 T.R. 482; 101 E.R. 272.

<sup>313</sup> Under BEA s 55(1)(a)(1) (codifying *Starke v Cheeseman* (1700) 1 Ld. Raym. 538, 91 E.R. 1259, discussed in ch 9, text and nn 272–73 above), '[t]he drawer of a bill by drawing it . . . [e]ngages that on due presentment it shall be accepted and paid according to its tenor, and that if it be dishonoured he will compensate the holder or any indorser who is compelled to pay it, provided that the requisite proceedings on dishonour be duly taken'. While a general acceptance on a bill is also unconditional, this is not the case for a qualified acceptance, and hence, in principle, the acceptor's liability is not necessarily unconditional and absolute. See text around nn 350–52 below.

<sup>314</sup> RW Aigler, 'Conditions in Bills and Notes' (1928), 26 *Michigan Law Review* 471 at 480, fn 35.

<sup>315</sup> Where a bill or note is given by way of payment, the payment may be absolute or conditional. There is, however, a rebuttable presumption in favour of 'conditional payment'. See eg AG Guest, *Chalmers and Guest on Bills of Exchange, Cheques and Promissory Notes*, 17th edn (London:

contained in a specialty contract ('obligation') on the contract evidenced by it. As early as 1422 it was determined that 'if I am your debtor . . . by a simple contract and I make an obligation to you for the same [amount] on the same contract . . . I am discharged of the contract by obligation.'<sup>316</sup>

It was settled under Medieval common law that 'in Debt on a contract the plaintiff shows in his count for what cause the defendant has become his debtor: otherwise in Debt on an obligation [that is, specialty], for the obligation is a contract in itself.'<sup>317</sup> Being of 'high nature', the undertaking under a specialty contract was divorced from the consideration thereto and could not be varied or contradicted by any extrinsic evidence. 'The defendant was bound by the deed, the whole deed and nothing but the deed.'<sup>318</sup> Accordingly, failure of consideration under the basic transaction did not constitute at common law a valid defence to an action on the deed.<sup>319</sup>

The inability of the obligor to meet an action on it by defences arising from the underlying transactions makes the obligation autonomous or abstract. However, the origin of this autonomy or abstraction is not easily traceable.

As a matter of Roman law terminology, a written obligation is autonomous or abstract when it is under a literal, unilateral, *stricti juris*, and formal contract.<sup>320</sup> As discussed earlier,<sup>321</sup> outside Roman law, already in the middle of the second century CE, Gaius was familiar with an obligation by writing, or even more specifically, a 'literal obligation'.<sup>322</sup> Such an obligation appears to arise through the documents called in Greek 'chirographs' and 'syngraphs',<sup>323</sup> however, Roman law

Sweet & Maxwell, Thomson Reuters, 2009) at 497. See also A Barak, 'The Uniform Commercial Code – Commercial Paper: An Outsider's View, Part II' (1968), 3 *Israel Law Review* 184 at 214; and F Kessler, EH Levi and EE Ferguson, 'Some Aspects of Payment by Negotiable Instrument: A Comparative Study' (1935–36), 45 *Yale Law Journal* 1373 at 1374. The doctrine of conditional payment (except for when the instrument is signed by a bank) is presently provided for by §3-310(b) of the American U.C.C., above n 9.

<sup>316</sup> *Salman v Barkyng* (1422) Y.B. 1 Hen. VI, reprinted in (1933), 50 *Selden Soc.* 114 at 115 per Babington J. Note the medieval terminology: 'contract' is not 'promise' but the benefit conferred on the defendant under the transaction. 'Obligation' is the specialty contract. See Fifoot, *History*, above n 147 at 225.

<sup>317</sup> *Anon* (1385), Bellewe 111, 72 E.R. 47 (the English translation, according to Fifoot, *History*, *ibid* at 225).

<sup>318</sup> Fifoot, *History*, *ibid* at 231.

<sup>319</sup> Ames, above n 39 at 108.

<sup>320</sup> See ch 5, section 1 above.

<sup>321</sup> Chapter 5, text around n 206.

<sup>322</sup> F De Zulueta, *The Institutes of Gaius*, Part I: Text with Critical Notes and Translation (Oxford: Clarendon Press, 1946) at 195.

<sup>323</sup> F De Zulueta, *The Institutes of Gaius*, Part II: Commentary (Oxford: Clarendon Press, 1953) at 166, who explains that while the *chirograph* was a letter written by the debtor addressed to the creditor, the *syngraph* was a witnessed document sealed by both parties and deposited with an official. While the *chirograph* was signed only by the debtor, the *syngraph* was signed by both parties. See A Berger, *Encyclopedic Dictionary of Roman Law* (Philadelphia: American Philosophical Society, 1953) at 388 (v. *Chirographum*) and 727 (v. *Syngraphe*). De Zulueta further asserts that according to the modern view, 'documents in either form could be abstract contracts, though purporting to be evidence of a debt from some (fictitious) *causa*, the commonest fiction being that of a loan'. *Ibid*. For the latter point, cf JW Jones, *The Law and Legal Theory of the Greeks: An Introduction* (Oxford: Clarendon Press, 1956) at 220–22.

declined to adopt such legal instruments, and their precise legal underpinning may not be adequately clear.<sup>324</sup> For its part, as also already discussed,<sup>325</sup> the Jewish Talmud requires a documentary note of indebtedness to be a *shetar*; it thus has to comply with formality requirements,<sup>326</sup> even if only as to adequate witnessing.<sup>327</sup> However, the Talmud allows for the issuance of a legal document whose binding effect and terms may be subject to conditions not provided therein but rather orally stated by the issuer at the time of the issue.<sup>328</sup> As such, under the Talmud, the documentary note is not a *stricti juris* contract, and is thus incapable of being the source of the English deed.

Rather, the autonomy of the English deed resembles the abstract nature of the Roman law *stipulatio*. Being self-contained, namely, confined to the contours of the formula and not to any outside event, the *stipulatio* is a formal, unilateral, and *stricti juris* contract. However, the *stipulatio* is a verbal contract, solemnly concluded in a face-to-face exchange of a question and an answer between two persons.<sup>329</sup> It is not a literal, namely, written, contract. Indeed, it is possible for the origins of the English specialty to be traced to formal notarized documents appearing around the time of Justinian,<sup>330</sup> the latter being ‘the sole basis of the engagement’ agreed upon,<sup>331</sup> at the same time, the underlying legal theory of the specialty is that of a Roman unilateral *stricti juris* formal contract. However, contrary to the verbal *stipulatio*, the English specialty or deed is a literal contract.

Along similar lines Ames was of the view that ‘[i]n Scotland, and in Europe generally, a bill or note is recognized to be a *literarum obligatio*’.<sup>332</sup> As a general

<sup>324</sup> Cf eg Berger, *ibid* at 727, according to whom ‘[i]t is doubtful whether a *syngraphe* was valid if the obligation assumed therein by a party was not based on a real transaction.’

<sup>325</sup> See ch 7, text and nn 64–65 above.

<sup>326</sup> ‘Every *shetar*, as a formal document, requires the signatures of witnesses.’ Otherwise, an informal unwitnessed document is a mere piece of evidence for an oral contract. See AM Fuss, ‘Shetar’ in M Elon (ed), *The Principles of Jewish Law* (Jerusalem: Keter Publishing House, 1975) (reprinted from *Encyclopaedia Judaica*, 1st edn), Columns 183–09 at 184. But according to the Rambam, for a documentary note of indebtedness on a loan (*shetar hov*) manually written by the debtor there are no formal requirements other than as to witnessing. See Rambam, *Mishpatim: Hilehot Malvé ve-Lové* Section 11, Rule 2, as well as Section 27, Rule 1.

<sup>327</sup> The Talmud records a disputation as to whether a documentary note of indebtedness (*Shtar Hov*) has to meet witnessing requirements. See Talmud, *Gitin* at 86B. Maimonides upholds witnessing requirements with respect to either the signature of the debtor or the delivery by him of the document to the creditor. See Rambam, *ibid* Section 11, Rules 2 and 3. According to the Magid Mishna commentary to the Rambam, *ibid*, this reflects the majority view among the post-Talmud Rabbis. Delivery witnesses as a replacement for signature witnesses are discussed eg by Rashi, Talmud, *Bava Batra* at 176 D’H ‘Vegoveh’. Witnessing requirements are also discussed in Choshen Mishpat Sections 40 and 51 in both *Tur* and *Shulchan Aruch*.

<sup>328</sup> See eg Talmud, *Gitin*, at 84B (a bill of divorce subject to external conditions) and *Ketuvot* at 19B (validity of testimony as to a condition). Cf Shulchan Aruch, *Choshen Mishpat*, Section 73, Rules 3–4 (including Shach 9), in conjunction with Rule 1, where a lender lost upon failure to prove an alleged condition.

<sup>329</sup> See ch 5, section 6 above.

<sup>330</sup> For formal notarized documents under Justinian (and shortly before him), see Usher, above n 3 at 41–44.

<sup>331</sup> *Ibid* at 42.

<sup>332</sup> Ames, above n 39 at 115, fn 2.

statement this may be an overgeneralization; in fact this characterization is correct for Germany, and not for France. However, the Continental approach does not prove to be helpful. In both Germany and France, pragmatic considerations prevailed,<sup>333</sup> so that the issue of a bill or note does not novate the obligation for which the instrument was given. As a result, defences arising from the underlying transaction are not forfeited and remain available to the obligor against the payee, and in fact against any transferee other than in good faith.<sup>334</sup>

In turn, foreshadowing this Continental position for bills and notes, the abstract nature of the obligation on a deed under the Common Law was seriously compromised in England by the Chancellor. In Courts of Equity defences founded on the conduct of the obligee on a specialty could successfully be raised. Thus, 'whenever it was plainly unjust for [the obligee] to insist upon his strict legal right' the Chancellor would 'furnish the obligor with a defense by enjoining the action.'<sup>335</sup> Equitable jurisdiction encompassed the defence of failure of consideration under the underlying contract.<sup>336</sup> Effectively then, the absolute discharge conferred by Law for a simple debt paid by deed did not prevent equity from allowing the party liable to meet the action on the deed with defences arising from the contract that gave rise to the debt.

Though in itself not a specialty,<sup>337</sup> a negotiable instrument has been characterized as 'the modern mercantile specialty'.<sup>338</sup> Chaffee accordingly suggested that equities affecting the right to sue upon the instrument ('equities as to liability') are parallel to grounds upon which an obligor on a specialty 'would before modern statutes<sup>339</sup> have had to go into chancery to maintain his defense.'<sup>340</sup> True, the availability of failure of consideration against an action on a specialty contract is supported by case law dealing with total failure of consideration alone.<sup>341</sup> However, once the veil separating the deed and the basic transaction has been pierced, no logical line can be drawn between different types of defences available on the underlying contract.

<sup>333</sup> Albeit compared to France, in Germany, where the bill or note is truly a *literarum obligatio*, both the reasoning leading to that result – and the procedural mechanisms to achieve it – are much more torturous. See cites in the following note.

<sup>334</sup> See eg L Dabin, *Fondements du Droit Cambiaire Allemand* (Liège, Faculté de Droit de Université de Liège, 1959) at 204–13, 261–66, 334–43, 422–27 (for Germany); C Gavalda and J Stoufflet, *Instruments de Paiement et de Crédit*, 7th edn edited by J Stoufflet (Paris: Litec, impr. 2009) at 59–61, 77 (for France); and G Ripert and R Roblot, *Traité de Droit Commercial*, 13th edn (Paris: Librairie Générale de Droit et de Jurisprudence, 1992) at 144, 156–60, 216–20 (for France with a comparison to Germany). For an extensive discussion see P Lescot and R Roblot, *Les Effets de Commerce* (Paris: Rousseau, 1953) at 98–120.

<sup>335</sup> Ames, above n 39 at 106.

<sup>336</sup> *Ibid* at 108–09. Other defences were fraud, illegality, payment, accord and satisfaction, discharge of surety, accommodation, duress, agreement not to sue and acquiescence.

<sup>337</sup> *Cf Rann v Hughes* (1778) 7 T.R. 350 at n. (a), 101 E.R. 1014 at n. (a).

<sup>338</sup> Ames, above n 39 at 115.

<sup>339</sup> *Common Law Procedure Act*, 1854 (UK), 17 & 18 Vic., c. 125, s 83.

<sup>340</sup> Z Chaffee, 'Rights in Overdue Paper' (1917–18), 31 *Harvard Law Review* 1104 at 1111.

<sup>341</sup> *Tourville v Naish* (1734) 3 P. Wms. 307, 24 E.R. 1077, and a 'case of the time of Henry VI' whose facts are outlined by Ames, above n 39 at 108.

In the final analysis, the analogy to a specialty or a deed does not identify the theory underlying the defence-free position of a holder of a negotiable instrument. First, English law classifies the obligation on a negotiable instrument as one on a 'simple contract' rather than a deed. Second, the defence-free position of a claimant on a deed at common law was anyway reversed by equity. Third, the German characterization of the negotiable instrument as a *literarum obligatio* too did not operate to insulate the holder from defences arising from the underlying transaction. Not surprisingly, even the characterization of the negotiable instrument under Anglo-American law as a 'modern mercantile specialty' does not render the obligation thereon absolute and defence-free. As previously indicated, this characterization may explain why, in suing on the instrument, the holder is relieved of the need to prove the liability of a party beyond producing the latter's signed instrument; and yet, this characterization does not preclude the signer from successfully meeting the action on the instrument by proving defences arising from the underlying transaction.<sup>342</sup>

More recently, it has been said that a bill of exchange<sup>343</sup> 'is itself a contract separate from the [underlying] contract of sale', operating 'as a contract in its own right'.<sup>344</sup> This, however, should not necessarily result in the insulation of a holder of the bill from the defences arising from the underlying sale. Thus, in line with Chafee's analysis, it was said that '[t]he laws distinguishing negotiable from non-negotiable instruments are not based upon any inherent distinctions between the obligations assumed in the one class or the other of such contracts'.<sup>345</sup> According to this view, the unconditionality of the engagement on a negotiable instrument goes to form only and is not a matter of substance. The right to meet an action on the instrument with defences based on the underlying transaction is thus not to be barred by the unconditional language of the engagement. 'The content of a promise [or order] is one thing, the development and recognition of a defense quite another'.<sup>346</sup>

The view that prevailed in English law is that the defence-free position of a holder is not premised on the unconditional language of the engagement of the party liable; rather it is based on the good faith purchase for value of the instrument by the holder. On this basis, protection is available only against defences of a party with whom the holder has not dealt as, for example, when the holder is an endorsee and is suing a maker of a promissory note. In fact, this is in line with the prevailing view in the Continent. Indeed, the defence-free position enjoyed by a purchaser who meets certain conditions – rather than by any other

<sup>342</sup> For the promissory and the specialty document, see section 3 above.

<sup>343</sup> Certainly, there is no reason to suppose that the ensuing statement is limited to bills; rather, it equally applies to notes.

<sup>344</sup> *Nova (Jersey) Knit Ltd v Kammgarn Spinnerei GmbH* [1977] 1 W.L.R. 713 (H.L.) at 733 per Lord Russell of Killowen. See also *Anglo-Italian Bank v Wells* (1878) 38 L.T. 197 (C.A.) at 199. The 'separate contract' theory in these cases led to a result discussed in text at nn 391–96 below.

<sup>345</sup> *Pitman v Walker* (1922) 187 Cal. 667 at 672 (S.C.), cited with approval by Aigler, above n 314 at 479, fn 33.

<sup>346</sup> Aigler, *ibid* at 480.



holder of the instrument – is considered a most remarkable feature of the law of bills and notes.<sup>347</sup>

Hence, it is the good faith purchase of an instrument, containing an unconditional promise or order, which gives the holder a defence-free position. On this basis, Ames links the holder's freedom from defences arising from the underlying transaction to the abstract nature of the obligation on the instrument which materializes only upon its negotiation in good faith and for value.<sup>348</sup> While this wording appears to bridge the gap between the unconditional language and the taking by negotiation, certainly, it is the latter which confers a defence-free position on a remote party and not on an immediate one. Otherwise, had the unconditional language been the determinative factor there would have been no reason to distinguish between such parties and confer the defence-free position only on a remote one. Indeed, in theory, it is possible to view the unconditional undertaking as intended by the promisor to benefit only a good faith purchaser for value. However, in my view, this reverses the cause and effect. It is the good faith purchase of the instrument, and neither language per se nor intention, which effectively renders the promisor's undertaking absolute. As well, it is illogical to construe the terms of an undertaking as different by reference to the 'quality' of the one who will enforce it. Accordingly, speaking of a negotiable instrument as merely 'formally abstract' between immediate parties and yet 'materially abstract' only between remote parties, Cowen and Gering appear to recognize that it is the good faith taking by the remote party which confers on him a defence-free position.<sup>349</sup>

Some support for the argument not to attribute negotiability to the abstract obligation stated on the instrument comes from the fact that negotiability is not removed from a bill for which a qualified acceptance (to the unconditional order) is given. The latter is an acceptance, which is 'conditional, that is to say, which makes payment by the acceptor dependent on the fulfilment of a condition therein stated.'<sup>350</sup> In principle, a bill so accepted is no less negotiable than a bill bearing a general acceptance, namely, an acceptance on which the drawer 'assents without qualification to the order of the drawer.'<sup>351</sup> Both types of bills circulate free of defences and claims. For its part then, the qualified acceptance is not abstract. True, a qualified acceptance may be treated by the holder as a dishonour of the bill, so as to allow him to take action against the drawer, whose secondary liability remains absolute on an abstract obligation. Moreover, the qualified acceptance may discharge non-assenting parties liable on the bill.<sup>352</sup> All of this, however, does not preclude the bill bearing the qualified acceptance

<sup>347</sup> On this point, as common lawyers, Cowen and Gering, above n 4 at 103 specifically agree with the civilian Dabin, above n 334 at 129.

<sup>348</sup> Ames, above n 39 at 115, text and n 2.

<sup>349</sup> Cowen and Gering, above n 4 at 92–93.

<sup>350</sup> BEA s 19(2)(a). Early leading cases are *Petit v Benson* (1697) Comb. 452, 90 E.R. 586 and *Sproat v Matthews* (1786) 1 T.R. 182, 99 E.R. 1041.

<sup>351</sup> BEA, *ibid* s 19(2).

<sup>352</sup> *Ibid* s 44(2) and (3).

from being 'negotiable' notwithstanding the non-abstract obligation it bears. Hence, it is the good faith purchase for value which counts.

According to Holden,<sup>353</sup> the first judicial pronouncement explicitly standing for the ability of a bona fide holder for value of a bill of exchange to acquire a better title than that of his transferor was *Hussey v Jacob* (1696).<sup>354</sup> The case involved a bill of exchange given to the payee in settlement of a gaming debt owed to him by the drawer. The bill was thus tainted with illegality.<sup>355</sup> On this basis, the payee's action against the acceptor was dismissed. Nonetheless, Lord Holt expressed his opinion in that case that if a bill drawn by the losing gambler<sup>356</sup> 'was given to the winner or order, and the winner endorsed it to a stranger for a just debt, and the person upon whom the bill was drawn, accepts it in the hands of the stranger, the acceptor would be liable.'<sup>357</sup>

Lord Holt's statement in *Hussey v Jacob* was an obiter dictum. But '[t]welve months later, [the] principle was applied in the Court of Chancery.'<sup>358</sup> In *Anon* (1697)<sup>359</sup> an endorsee for value of a bill of exchange sued its drawer. The drawer brought a bill to be relieved in equity against a judgment given against him by a court of law. The drawer's argument was that 'there was really no value received at the giving of this bill, and [the endorsee] would have no prejudice [and] might still resort to [his endorser] upon his original debt.'<sup>360</sup> The drawer's defence of absence of consideration was rejected unequivocally. The endorsee was 'an honest creditor . . . coming by this bill fairly for the satisfaction of a just debt.'<sup>361</sup> The Chancellor held that relieving the drawer 'would tend to destroy trade which is carried on [everywhere] by bills of exchange, and . . . lessen an honest creditor's security.'<sup>362</sup> The ultimate decision was thus against the drawer. Having earlier exposed the signer of a 'specialty contract' to defences to his liability on the underlying transaction, a Court of Equity was nevertheless the first court to protect the bona fide for value endorsee of a bill from such defences.

The insulation of a bona fide purchaser from a prior party's contract defences may also be supported by *Haly v Lane* (1741).<sup>363</sup> It was held there that, where an endorsee gave money for a void instrument, 'it is a good note as to him, unless there should be some fraud or equity against him appearing in the case.'<sup>364</sup> However, in *Haly v Lane* (1741), the endorsee sued his endorser. It is thus uncertain whether the statement was intended to apply to the endorsee's position

<sup>353</sup> Holden, above n 9 at 63.

<sup>354</sup> 1 Comyns. 4, 92 E.R. 929.

<sup>355</sup> Under the *Gaming Act*, 1664, 16 Car 2, c. 7. See Holden, above n 9 at 63.

<sup>356</sup> While Lord Holt speaks of 'a note', the instrument involved in the case was a bill of exchange. Lord Holt must have used the term 'note' rather loosely.

<sup>357</sup> Above n 354 at 6 (Comyns), 930 (E.R.).

<sup>358</sup> Holden, above n 9 at 64.

<sup>359</sup> 1 Comyns. 43, 92 E.R. 950.

<sup>360</sup> *Ibid* at 43 (Comyns.), 950 (E.R.).

<sup>361</sup> *Ibid*.

<sup>362</sup> *Ibid*.

<sup>363</sup> 2 Atk. 181, 26 E.R. 513.

<sup>364</sup> *Ibid* at 181 (Atk.), 513 (E.R.).

vis-a-vis a prior party or merely to his power to enforce the instrument as against his immediate endorser.

In *Peacock v Rhodes* (1781),<sup>365</sup> a good faith purchaser for value of a bill of exchange endorsed in blank, who derived his title from a thief, sued the drawer. Treating the instrument as a bill payable to bearer,<sup>366</sup> in the footsteps of *Miller v Race* (1758),<sup>367</sup> Lord Mansfield held in the plaintiff's favour. The doctrine of negotiability was thus applied in that case to cut off prior *claims* of ownership. Nonetheless, according to Britton, the rule established thereby 'also cut off *defenses* of prior parties' (emphasis added).<sup>368</sup> Presumably he stated this conclusion on the basis of Lord Mansfield's statement in *Peacock v Rhodes* (1781) according to which, unlike an assignee who 'must take the thing assigned, subject to all the equity to which the original party was subject', 'a holder, coming fairly by a bill or note, has nothing to do with the transaction between the original parties.'<sup>369</sup> According to Lord Mansfield, this was 'within the principle' of *Miller v Race*; in his view, if the rule under which the assignee of a debt is subject to defences arising between the original parties 'applied to bills and promissory notes, it would stop their currency.'<sup>370</sup> The protection of a good faith purchaser for value of a bill from contract defences was thus conceptualized not on the basis of equity but rather on the common law 'currency rule' pronounced in *Miller v Race* for banknotes.

The effect of the doctrine of negotiability to cut off defences of prior parties also surfaced in *Trueman v Hurst* (1785),<sup>371</sup> *Morris v Lee* (1786),<sup>372</sup> and *Lickbarrow v Mason* (1787).<sup>373</sup> In *Trueman v Hurst* (1785) it was argued that '[i]n an action on a promissory note between the original parties, the consideration may be inquired into: but when it passes into the hands of third persons, it cannot.'<sup>374</sup> In *Morris v Lee* (1786) the court held that, 'however improperly [a note] might have been obtained, a third person who took it fairly, and gave consideration for it, was entitled to recover.'<sup>375</sup> In *Lickbarrow v Mason* (1787) the court observed with respect to a bill of exchange that 'as between the drawer

<sup>365</sup> 2 Doug. 633, 99 E.R. 402.

<sup>366</sup> A position adopted by modern law, as per BEA s 8(3), above n 6, providing that '[a] bill is payable to bearer which is expressed to be so payable, or on which the only or last indorsement is an indorsement in blank.' See text and n 293.1 above.

<sup>367</sup> Above n 145.

<sup>368</sup> WE Britton, *Handbook of the Law of Bills and Notes*, 2nd edn (St. Paul, Minn.: West Publishing Co., 1961) at 245, text and fn 7.

<sup>369</sup> Above n 365 at 636 (Doug.), 403 (E.R.).

<sup>370</sup> *Ibid.*

<sup>371</sup> 1 T.R. 40, 99 E.R. 960.

<sup>372</sup> B.R.H. 26 Geo. 3, 1 Comyns. 43 at n. (1), 92 E.R. 950 at n. (1). See also J Bayley, *A Short Treatise on the Law of Bills of Exchange, Cash Bills, and Promissory Notes* (London: E Brooke, 1789) at 74 (appendix).

<sup>373</sup> 2 T.R. 63, 100 E.R. 35.

<sup>374</sup> Above n 371 at 40 (T.R.), 960–61 (E.R.). The litigants were immediate parties to the transaction so the point was not essential for the determination of the case.

<sup>375</sup> Above, n 372 at 43, n. (1) (Comyns.), 950, n. (1) (E.R.). In that case there was evidence that the maker 'was swindled out of the note', probably by the payee. However, 'the plaintiff took the note bona fide, and gave a valuable consideration for it.' *Ibid.*

and the payee the consideration may be gone into, yet it cannot be between the drawer and an indorsee'.<sup>376</sup>

The freedom of a subsequent bona fide holder for value from prior parties' defences comes out quite clearly in *Brown v Davies* (1789).<sup>377</sup> This was an action by an endorsee on a promissory note. Speaking of a precedent<sup>378</sup> holding that 'the maker, was entitled to set up [against the endorsee] the same defence that he might have done against the original payee',<sup>379</sup> Buller J added that '[a] fair indorsee can never be injured by this rule; for if the transaction be a fair one, he will still be entitled to recover.'<sup>380</sup> It was thus held in *Brown v Davies* (1789) that the defence of payment before maturity could not be raised against a bona fide purchaser.

Three years later, Lord Loughborough said in *Puget de Bras v Forbes* (1792)<sup>381</sup> that evidence as to an equity between the drawer and the payee 'would be inadmissible had the action been brought by an indorsee for a valuable consideration'.<sup>382</sup> This obiter dictum amounts to a complete recognition of the endorsee's freedom from a prior party's defences. In *Boehm v Sterling* (1797)<sup>383</sup> a bona fide purchaser for value of a cheque recovered from the drawer notwithstanding the latter's defence of failure of consideration. The discussion in that case revolved around the negotiability of a cheque and focused on whether the plaintiff actually was a bona fide purchaser. It is obvious from the reports that the power of a bona fide purchaser for value of a negotiable instrument to cut off a prior party's defences was not even questioned.

Surely, this outline explains the holder's defence-free position as resting on the same basis as that of his claim-free position, namely, on the good faith acquisition of value of the instrument.<sup>384</sup> As such, the freedom from a prior party's contract defences, exactly like the freedom from adverse claims, ought to be confined to the bona fide purchaser for value, that is, to the holder in due course ('HDC'). At present, the HDC's claim and defence-free position is

<sup>376</sup> Above n 373 at 71 (T.R.), 39 (E.R.). According to this decision. '[t]he rule is founded purely on principles of law, and not on the custom of merchants. The custom of merchants only establishes that such an instrument may be indorsed; but the effect of that indorsement is a question of law'. *Ibid.*

<sup>377</sup> 3 T.R. 80, 100 E.R. 466.

<sup>378</sup> The precedent is described as Buller J's own decision 'in the case in Cornwall' but does not provide the further information needed for identification. *Ibid* at 82 (T.R.), 467 (E.R.). Possibly it is '*Banks v. Coluwell* at Launceston Spring Assizes 1788, before Mr. Justice Buller' mentioned earlier in the report. *Ibid* at 81 (T.R.), 466 (E.R.).

<sup>379</sup> *Ibid* at 82 (T.R.), 467 (E.R.).

<sup>380</sup> *Ibid* at 82–83 (T.R.), 467 (E.R.).

<sup>381</sup> 1 Esp. 117, 170 E.R. 298.

<sup>382</sup> *Ibid* at 119 (Esp.), 299 (E.R.).

<sup>383</sup> 2 Esp. 575, 170 E.R. 460, further proceedings 7 T.R. 423, 101 E.R. 1055. According to Professor Beutel this was the first case of a bill or note where a bona fide purchaser recovered in spite of failure of consideration. FK Beutel, 'Colonial Sources of the Negotiable Instruments Law of the United States' (1940), 34 *Illinois Law Review* 137 at 138, fn 18. But he adds there a reference to 'Bewes' [earlier] confident statement of the Law Merchant to the effect that such defences were cut off, *Lex Mercatoria* (1752) 416 s. 14, 431 s. 132.' *Ibid.*

<sup>384</sup> As discussed in section 6.2 above.

codified in section 38(2) of the *Bills of Exchange Act*. Thereunder, the HDC<sup>385</sup> holds the instrument 'free from any defect of title of prior parties, as well as from mere personal defences available to prior parties among themselves, and may enforce payment against all parties liable on the [instrument].' This includes the right to enforce the instrument free from most prior parties' contractual defences.<sup>386</sup> Similarly, in the United States, under the *Uniform Commercial Code*, freedom from (i) any adverse claim, namely, 'a claim of a property or possessory right',<sup>387</sup> as well as from (ii) prior party's contract defences,<sup>388</sup> is reserved for the holder in due course.<sup>389</sup>

As for the holder not in due course ('HNDC'), namely a holder who becomes a party to, or acquires, a negotiable instrument without satisfying the holding in due course requirements, the position in the United States is not the same as in England. Between the two legal systems, it is American and not English law that draws the logically inevitable conclusion. Thus, at present, according to §3-305 of the *Uniform Commercial Code*, an action to enforce a negotiable instrument brought by an HNDC can be met by any 'defense . . . available' in an action for the enforcement of 'a right to payment under a simple contract'; the action can also be met by 'a claim in recoupment of the obligor against the original payee' arising 'from the transaction that gave rise to the instrument'.<sup>390</sup> In other words, an HNDC is subject to all defences available to a prior party on the underlying transaction.

Conversely, in dealing with rights of an HNDC, English law effectively adhered to the autonomy of the obligation on the instrument albeit, only in relation to the defence of unquantified partial failure of consideration. This may be attributed to the fact that as demonstrated above, leading cases establishing the HDC's freedom from defences to liability on the underlying transaction were concerned with

<sup>385</sup> The conditions for becoming a holder in due course are set out in BEA, above n 6, s 29(1) as follows: 'A holder in due course is a holder who has taken a bill, complete and regular on the face of it, under the following conditions; namely, (a) That he became the holder of it before it was overdue, and without notice that it had been previously dishonoured, if such was the fact; (b) That he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it.' The provision speaks of 'bill' but is made applicable to promissory notes by BEA s 89(1). Cheques are bills: BEA, *ibid* s 73.

<sup>386</sup> Real or absolute defences, arising 'from the invalidity or nullification of the instrument' are not included; hence even a holder in due course takes the instrument subject to them. See Guest, above n 315 at 343.

<sup>387</sup> U.C.C., above n 9, §3-306.

<sup>388</sup> U.C.C., *ibid* §3-305(b). As in English law, a holder in due course is however subject to 'real defences' enumerated in U.C.C. §3-305(a)(1).

<sup>389</sup> Under U.C.C., *ibid* §3-302, in principle, '(a) . . . "holder in due course" means the holder of an instrument if: (1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and (2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in §3-306, and (vi) without notice that any party has a defense or claim in recoupment described in §3-305(a).'

<sup>390</sup> U.C.C., *ibid* §3-305(a)(2),(3) and (b).

defences that would have extinguished liability and not merely reduced it. As discussed immediately below, this background may have given rise to a perception that under the law of bills and notes an obligation on an instrument is autonomous, namely, it is to the full amount of the instrument, so as not to be subject, even against an HNDC, to defences that reduce liability in an unquantified amount. This perception is reflected by the rules regarding the failure of consideration in the transaction that gave rise to the instrument.<sup>391</sup>

In the law of bills and notes ‘there is a failure of consideration where the performance is either absent, incomplete, or defective.’<sup>392</sup> Failure of consideration is thus interchangeable with the breach of the underlying contract for which the instrument was given. Non-performance, or defective (or incomplete) performance leading to repudiation, is total failure of consideration. Otherwise, ‘where some benefit has been received’, the failure of consideration is partial.<sup>393</sup> Partial failure of consideration may be quantified, namely, in a liquidated amount, as when a seller of goods provided them but not in the entire quantity. Alternatively, a failure of consideration may be unquantified, or in an unliquidated amount, as for example where the breach of the contract gives rise to a defence based on unliquidated damages caused by the breach.

In English law, an HNDC, even an immediate party to the underlying transaction, is allowed to recover the full amount of a negotiable instrument, free from the obligor’s defence of partial failure of consideration in an unliquidated amount. For the breach of the contract, the obligor is to bring a separate proceeding to recover damages from the immediate party in breach.<sup>394</sup> This result is rationalized as being premised on the view that a bill of exchange ‘is itself a contract separate from the [underlying] contract of sale’, operating ‘as a contract in its own right.’ In that respect, the function of the bill is ‘not merely to serve as a negotiable instrument’; rather, ‘it is also to avoid postponement of the purchaser’s liability to the vendor . . . grounded on some allegation of failure in some respect by the vendor under the underlying contract, unless it be total or quantified partial failure of consideration.’<sup>395</sup> Effectively, then, ‘[t]he payment by a bill of exchange is to be taken as the payment of so much cash; the defendant ought to satisfy the bill and proceed upon the remedy for the breach of warranty.’<sup>396</sup>

<sup>391</sup> For a comprehensive critical review, see Geva, *Financing*, above n 80 at 122–63, particularly at 152–62.

<sup>392</sup> Note, ‘Failure of Consideration in Negotiable Instruments’ (1925), 25 *Columbia Law Review* 83.

<sup>393</sup> *Ibid* at 86.

<sup>394</sup> A classic case is *James Lamont & Co Ltd v Hyland Ltd* (No 2) [1950] 1 All E.R. 929 (C.A.), dealing with the payee-seller’s action against the acceptor-buyer on a ‘trade acceptance’, namely, a bill of exchange drawn by the seller on the buyer, payable to the seller’s order, and accepted by the buyer. The failure of consideration in an unliquidated amount alleged by the buyer-acceptor was not allowed against the seller-payee-holder by way of defence, counterclaim, or even stay of execution. Rather, the buyer-acceptor was required to pay the full amount of the bill – and sue the seller in a separate action.

<sup>395</sup> *Nova (Jersey) Knit Ltd v Kammgarn Spinnerei GmbH*, above n 344 at 732–33.

<sup>396</sup> *Warwick v Nairn* (1855) 10 Ex. 762 at 764, 156 E.R. 648 at 649.

Legal doctrine in England can thus be summarized as follows. The freedom of the HDC from contract defences of a remote party is premised on the good faith purchase for value of the instrument by the HDC. At the same time, the freedom of the HNDC from the defence of partial unquantified failure of consideration is rationalized on the autonomy of the obligation on the instrument. However, this autonomy of the obligation is not good enough to insulate the HNDC from the defence of full or quantified partial failure of consideration.

Finally, rationalizing the HDC doctrine on the basis of good faith purchase for value of the instrument, as is the case in England, has its own limitations. For example, where the payee is a remote party vis-a-vis the acceptor, the former is nevertheless not a purchaser of the instrument; more specifically, in the *Bills of Exchange Act* statutory language, he is not one to whom the bill was 'negotiated', as required to become a HDC.<sup>397</sup> Hence, the HDC doctrine cannot explain the payee's freedom from defences of the acceptor against the drawer.<sup>398</sup>

This difficulty is bypassed altogether in the Continent; Geneva Uniform Laws specifically say that parties sued on a negotiable instrument 'cannot set up against the holder defences founded on their personal relations' with other parties 'unless the holder, in acquiring the [instrument], has knowingly acted to the detriment of the debtor.'<sup>399</sup> Whether the holder took the note by 'negotiation' or otherwise does not appear to matter.

Also on that point the American *Uniform Commercial Code* improved on English law; thus the *Uniform Commercial Code* does not require 'negotiation' to an HDC; rather, to become an HDC, it is sufficient for the holder to *take* the instrument on conditions amounting to good faith and for value.<sup>400</sup> Having taken the instrument as so required, the HDC is 'not subject to defenses of the obligor . . . against a person other than the [HDC]' himself.<sup>401</sup> Accordingly, under the *Uniform Commercial Code*, there is no difficulty in allowing a payee, as a holder in due course, to recover from the acceptor, free from the acceptor's defences against the drawer.<sup>402</sup>

In conclusion, the defence-free position of a holder in due course has been theorized in English law on the good faith for value acquisition of the instru-

<sup>397</sup> BEA, above n 6, s 29(1)(b), reproduced in n 385 above.

<sup>398</sup> For the view that the payee, though not a holder in due course, may have similar rights against the acceptor, see N Elliott, J Odgers and JM Phillips, *Byles on Bills Of Exchange and Cheques*, 28th edn (London: Sweet & Maxwell, 2007) at 237–38. But see *Ayres v Moore* [1940] 1 K.B. 278 at 288 (C.A.), treating the payee as an immediate (rather than remote) party with the acceptor who, as such, is unable to overcome the acceptor's defence based on third party's fraud. The *locus classicus* in English law for the proposition that a payee, as an original party to the instrument and not its purchaser, cannot be a holder in due course is *RE Jones Ltd v Waring and Gillow, Ltd* [1926] A.C. 670. For a discussion on the transformation of the premises of the HDC doctrine into good faith purchase for value, see ch 9, text and nn 325–40 above.

<sup>399</sup> ULB, above n 188, art 17; and ULC, above n 188, art 22.

<sup>400</sup> U.C.C., above n 9, §3-302(a)(2), reproduced in part in n 389 above.

<sup>401</sup> U.C.C., *ibid* §3-305(b). As in English law, a holder in due course is however subject to real defences enumerated in U.C.C. §3-305(a)(1).

<sup>402</sup> For the payee as a holder in due course under the U.C.C., see Official Comment 4 to U.C.C., *ibid* §3-302.



ment, so as to facilitate the circulation of the instrument and bring its 'currency' quality to 'perfection'. On its own, the unconditional language has not been instrumental in rendering the obligation abstract and autonomous; and yet, in English law, the 'abstraction' feature played a limited, albeit somewhat inconsistent, role in determining the rights of an HNDC.

However, purporting to facilitate circulation, negotiability also accorded a defence-free position to an endorsee of a credit note, issued by a retail buyer of goods, in circumstances where it had been contemplated that the note would be negotiated only once, to a particular endorsee, known in advance, and not onward. Stated otherwise, negotiability conferred currency features to what has effectively been a non-circulating, or not freely-circulating, note. Particularly in Canada and the United States, holding in due course has thus been used by assignees of retail sale contracts to confer on them a defence-free position as if they were direct purchase-money lenders to the retail buyers. This has been abused, particularly in cases of a close business connection between an assignee/financer and a vendor of goods.<sup>403</sup>

Similarly, negotiability is applied to protect a collecting bank from contract defences that a drawer of a cheque may have against the payee (depositor of the cheque, customer of the collecting bank). Negotiability is also applied in the case of a documentary sale between two distant parties, to protect a seller's bank, advancing funds against the seller's documentary draft drawn on the buyer. In all such cases, in according protection from contract defences, but not for the facilitation of the circulation of paper, negotiability has been the subject of criticism.<sup>404</sup>

In the final analysis, the original function of material negotiability was to implement 'the currency rule', namely, the protection of a holder deriving title from a lawful possessor against adverse claims to the instrument. Both for bank-notes and instruments payable to order, negotiability served to enhance the free circulation in paper. For the latter, it partly served a role substantially similar to that of rules of law protecting a bona fide buyer of goods acquired from a non-owner in lawful possession of them.

Nevertheless, in connection with credit notes as well as the collection of cheques and documentary drafts, in protecting the endorsee from contract defences of a remote party liable thereon, negotiability has acquired different roles, only in order to make its transformed rationale controversial. Indeed, the tremendous historical importance of negotiability must be recognized; however, other than for facilitating the flow of money, at present, negotiability stands on a tenuous foundation.

<sup>403</sup> This topic is the theme of Geva, *Financing*, above n 80.

<sup>404</sup> See eg AJ Rosenthal, 'Negotiability – Who Needs It?' (1971), 71 *Columbia Law Review* 375.

7. CONCLUSION: FINAL REFLECTIONS ON 'NEGOTIATION'  
AND 'NEGOTIABILITY'

The discussion in this chapter set out the evolution of 'negotiation' and 'negotiability' in English law. This concluding section is a brief outline putting this process in the context of a broader perspective.

As an order to pay, the bill of exchange is reminiscent of the delegation order. In turn, the drawee's acceptance on the bill is reminiscent of the execution of the delegation order by means of *receptum*, *constitutum* or *stipulatio*.<sup>405</sup> Furthermore, most frequently, the *constitutum* was given by means of a letter sent by the promissor; such a letter, *l'epistola*, became the property of the addressee upon receipt, so that its issuance bore resemblance to the delivery of a bill (or note).<sup>406</sup> Moreover, Roman law facilitated both the *novatio* and *cessio* of debts.<sup>407</sup> Thus, while Roman law did not provide for formal 'literal' documents, it gave rise to practices that, in hindsight, foreshadowed bills of exchange.

Formal debt documents may go back to the Greek 'chirographs' and 'syngraphs'.<sup>408</sup> Transferability of debt documents can be traced to Mesopotamia,<sup>409</sup> the legal underpinning of a formalized transfer goes back to the Jewish Talmud,<sup>410</sup> and informal transfer of informal debt documents appears to be an innovation introduced by the Muslims.<sup>411</sup>

Debt circulation was facilitated by the Romans.<sup>412</sup> Yet, it was the circulation of the bill of exchange in late Medieval Continental Europe by means of a chain of endorsements<sup>413</sup> that subsequently facilitated, in post-Medieval England,<sup>414</sup> side by side with the appearance of the banknote as money,<sup>415</sup> the emergence of negotiability as a mechanism for the circulation of debt instruments. As outlined above in section 6.2 of this chapter, between these two sources, it was the treatment of the banknote as money that 'upgraded' negotiability to be not only 'procedural', namely concerned with the transferability by delivery (with or without endorsement), but also 'material', namely capable of conferring on the transferee a better title than that of the transferor.<sup>416</sup> When the banknote

<sup>405</sup> For (i) the legal nature of the delegation order, (ii) *receptum* and *constitutum*, and (iii) *stipulatio* in Roman law see ch 5, sections 3, 5, and 6 respectively.

<sup>406</sup> See ch 5, n 96 and text around it above.

<sup>407</sup> For *novatio* and *cessio* in Roman law, see above, ch 5, sections 6 and 9 respectively.

<sup>408</sup> See ch 5, nn 207–09 and accompanying text above. See also in this chapter, text and nn 319–23 above.

<sup>409</sup> See ch 3, section 2, text around nn 33–44 above.

<sup>410</sup> See ch 7, section 2.1, text and nn 61–75.

<sup>411</sup> See ch 6, particularly section 3.1, text around nn 117–28; section 3.2; section 3.3, text around nn 190–201; and section 4, text and nn 238–48.

<sup>412</sup> See ch 5, particularly section 10.2 above.

<sup>413</sup> See ch 8, section 5 above.

<sup>414</sup> See section 2 of this chapter above.

<sup>415</sup> See ch 10, sections 2.2 and 3.2, as well as section 4 of this chapter above.

<sup>416</sup> For this distinction see section 1, text at n 4 above.

heralded and converged with the promissory note,<sup>417</sup> and the cheque became a type of a bill of exchange,<sup>418</sup> the features of each of the three categories of instruments (namely, bills, notes and cheques) were molded and came to be governed as negotiable by the *Bills of Exchange Act*.

Ultimately, the 'negotiable instrument' came to be recognized as a document of title to a sum of money, transferable by delivery (either with or without an endorsement), and capable of conferring on the transferee title free of a third-party's adverse claims and prior parties' defences.<sup>419</sup> Its 'material negotiability', namely its transferability free from such claims and defences, is derived from its 'procedural negotiability', that is, transferability by delivery (either with or without an endorsement), namely, 'negotiation'.

At least insofar as its procedural negotiability is concerned, the negotiable instrument is 'a document of title to money'; it is 'a documentary intangible' serving as 'the physical embodiment of the payment obligation.'<sup>420</sup> Thereunder, '[t]he debt claim is "merged" into the paper evidencing the claim.'<sup>421</sup> In essence, the negotiable instrument falls under what in German jurisprudence is called a *Wertpapier*.<sup>422</sup> The latter is defined in Article 965 of the *Swiss Code of Obligations* as 'any document in which a right is incorporated in such a way that it cannot be claimed nor transferred to others . . . without the document.'<sup>423</sup>

However, these definitions do not convey the full sense of negotiability. Thus, material negotiability is not mentioned in the definitions of 'document of title to money' and *Wertpapier*; nor does it seem to be a necessary derivative of procedural negotiability.<sup>424</sup> Indeed, even for a document possessing both features of negotiability, such as a bill, note or cheque, governed by the BEA, to benefit from the procedural negotiability feature and succeed in an action on the

<sup>417</sup> As discussed particularly above in section 3 of this chapter. See also sections 4 and 6 of this chapter.

<sup>418</sup> As discussed above in section 5 of this chapter.

<sup>419</sup> Cowen and Gering, above n 4 at 52.

<sup>420</sup> E McKendrick, *Goode on Commercial Law*, 4th edn (London: Penguin Books, 2010) at 513. See also Cowen and Gering, *ibid* at 53.

<sup>421</sup> Gilmore, 'Good Faith', above n 291 at 1064.

<sup>422</sup> I agree with Cowen and Gering, above n 4 at 94 that the word *Wertpapier* cannot be well translated to English, so that words such as 'security' or 'commercial paper' do not convey its accurate sense.

<sup>423</sup> *Swiss Code of Obligations*, English Translation of the Official Text, Vol III Securities, rev edn Law (Zurich: Swiss-American Chamber of Commerce, 2003). On the German *Wertpapier* see in general Dabin, above n 334 at 236–84. For a comprehensive discussion on the German conceptual framework, and as to whether it sheds additional light on the nature of a negotiable instrument, see Cowen and Gering, *ibid* at 79–98 (where a slightly different translation, albeit to the same effect, of the Swiss provision is reproduced at 82). Their negative conclusion as to whether the *Wertpapier* sheds additional light on the nature of a negotiable instrument, *ibid* at 110, is criticized by JT Pretorius' review of the book, (1986), 103 *South African Law Journal* 151 at 154–56. On the negotiable instrument as *Wertpapier* see also FR Malan, JT Pretorius and SF Du Toit, *Malan on Bills of Exchange, Cheques and Promissory Notes in South African Law*, 5th edn (Durban: LexisNexis, 2009) at 4, 7.

<sup>424</sup> But cf Cowen and Gering, *ibid* at 96 as to whether what is characterized here as 'material negotiability' is a necessary attribute of the Germanic *Wertpapier*.

instrument, the claimant must be in lawful possession or at least have the right to lawful possession of it. However, to defeat adverse claims and prior-parties' contract defences, that is, to benefit from material negotiability, a claimant successfully suing on the instrument must be, in addition, a remote party, typically by taking the instrument by 'negotiation'.<sup>425</sup>

In the final analysis, the road to full negotiability was bumpy. Having originated to give effect to the 'currency' of evolving monetary objects, so as to facilitate the circulation of money, 'negotiability' proceeded to apply to 'bank money' as well as to a broader range of instruments which do not necessarily constitute money. Contrary to what may have been projected by the orthodox position, there was no preconceived notion of a 'negotiable instrument', only to be 'discovered' by relentless intellectual efforts of brilliant lawyers and judges.<sup>426</sup> Rather, the negotiable instrument had to be 'invented', or more accurately, to 'evolve'. Along lines originally put forward by Rogers<sup>427</sup> and developed in this chapter, not always in agreement with him,<sup>428</sup> there was an ongoing evolution and adaptation in pursuing short-term objectives and policies under which the law of separate instruments ultimately converged to generate a doctrine of negotiability. In the process, 'negotiability' gradually crystallized to unite the law of bills and notes into one branch of law and to turn the wheels of the post-Medieval transformation of the banking and payment systems. If negotiability is ultimately to disappear or at least be curtailed, it will not be because of inherent inadequacies the doctrine may have; rather, extinction or curtailment will happen only because of the ongoing effect of constantly changing conditions and circumstances.<sup>429</sup> Despite having proven its resilience, at least in its present understanding, 'negotiability' is by no means immortal. Like any legal doctrine, 'negotiability' is subject to the changing needs and values of the society in which it exists.

<sup>425</sup> Particularly, see Barak's article, above n 4 and more in detail, his book in Hebrew under the same title, *The Nature of the Negotiable Instrument*, (Jerusalem: Academic Press, 1972). Another comprehensive discussion on negotiability and negotiable instruments, in both analytical and comparative frameworks, is that of Cowen and Gering, *ibid* at 1–111.

<sup>426</sup> Certainly the text exaggerates; and yet, while nobody said so in so many words, this is the spirit in which I read, eg, the discussion by Holdsworth, above n 37 at 146–77. For a similar perception from the narrative of Holden, see ch 9, section 4, as well as section 3 of this chapter. In pointing at the 'orthodox bias' of these authors, nevertheless I do not wish to undermine their genuinely invaluable scholarly contribution.

<sup>427</sup> See eg Rogers, *Bills and Notes*, above n 33 at 164, 170, 173.

<sup>428</sup> In principle, I agree with Rogers that 'a major flaw in the traditional accounts of the development of the law of bills and notes is the preoccupation with the concept of negotiability'. *Ibid* at 170. At the same time, in my view he ends up belittling the role of negotiability both in uniting the law of bills and notes into one branch of law as well as in facilitating the post-Medieval transformation of the banking and payment system.

<sup>429</sup> See above in this chapter, towards the end of section 6.3.

# Staying on Course: The Footprint of Ancient and Medieval Doctrine and Practice on Modern Payment Laws

|                                                                                       |     |
|---------------------------------------------------------------------------------------|-----|
| 1. Introduction                                                                       | 585 |
| 2. Payment Services and their Providers                                               | 587 |
| 3. The Bank Deposit                                                                   | 596 |
| 4. The Payment Order and its Execution under Modern Law                               | 604 |
| 5. The Payment Order as a Mandate                                                     | 612 |
| 6. Paymaster's Obligation: Autonomy and Discharge                                     | 622 |
| 7. Conclusion: A 'Revisionist' View on a 'Decentralized' Non-customary 'Law Merchant' | 637 |

## 1. INTRODUCTION

**T**HIS CHAPTER IS designed to link modern funds transfers and payment law to the evolution of the law that governed the order to pay money in Antiquity and the Middle Ages. The chapter covers six principal subjects, each dealt with in a separate section. Section 2 discusses payment services in the form of funds transfers, and the providers of such services. Section 3 deals with the bank deposit. Section 4 presents a summary of the treatment of the payment order and its execution under modern law. Section 5 analyses the payment order as a mandate. Section 6 covers the autonomy and discharging effect of the paymaster's obligation. Drawing on the earlier parts of this chapter, section 7 concludes with the presentation of a 'revisionist' view on a 'decentralized' non-customary 'law merchant'.

The discussion covers both common and civil law in major jurisdictions. It encompasses general principles of law and legislation covering obligations, as well as specific legislation covering funds transfers, bills of exchange and cheques. Insight on negotiability and most aspects of negotiable instruments was given in chapters nine, ten and eleven.

Linkage between modern law and the law of Antiquity and the Middle Ages is done in two ways. First, modern law is discussed by reference to past law. Second, the discussion points out concepts and issues that arose in past law and

the impact of their treatment on the resolution of issues in modern law. Analysis of previous law frequently reproduces an earlier discussion in this book. Some other parts of the discussion of modern law can easily be traced to my previous book.<sup>1</sup> However, the discussion of these materials in this chapter puts them in a different context.

Throughout this book, the connection between deposit taking and funds transfer activities of banks has been highlighted. Indeed, deposit banking has provided the infrastructure for funds transfers from one deposit to another. This explains the centrality of the discussion on the legal nature of the bank deposit in the context of legal aspects of funds transfers. It is in the context of this centrality that legal principles governing funds transfer are discussed below. On its own, this centrality merits some explanation.

As a financial activity, deposit banking consists of the intermediation between depositors-savers and borrowers; that is, the banker uses money deposited with him to make loans in his own name, namely, for his own profit and at his own risk.<sup>2</sup> Effectively, lending out of deposits at a rate higher than that paid to depositors is the way for bankers to make profit; this practice provides bankers with the incentive to expand their deposit base from which they can gainfully lend. One way bankers attract deposits payable at a low interest rate is by the facilitation of non-cash payment transactions from one deposit to another at a reduced, and thus effectively subsidized, fee. Consequently, it is in an environment of flourishing deposit banking that a thriving non-cash payment system is likely to be found.

At the same time, the present research shows that the history of deposit banking is checkered. As demonstrated above in chapter three, following its origins and consolidation in Ancient Greece and Rome, deposit banking regressed in Greco-Roman Egypt and disappeared in the West in the early Middle Ages. As was shown above in chapter six, religious tenets of Islam, which took hold of the East, are incompatible with the growth of deposit banking. Per the discussion in chapter eight above, deposit banking was ‘resurrected’ in the late Middle Ages in Continental Europe, only to recede and lose ground to non-lending deposit-taking public banks. Chapter ten above demonstrated that deposit banking was reborn in post-Medieval England in a model that was exported elsewhere to form the basis for the global payment system as we know it today.

Certainly, there is nothing to suggest that the present deposit banking model, as set out above in chapter ten, is invincible and eternal. Indeed, particularly when put in the historical context outlined above, recent banking crises may truly be an omen. For its part, enhanced technology has proved to be a double-edged sword; on one hand it has increased the potential for development and growth while, on the other hand, it has increased risk, which stands in the way of long-term growth. As a result, no prediction as to the future of the present

<sup>1</sup> B Geva, *Bank Collections and Payment Transactions* (Oxford: Oxford University Press, 2001) (hereafter: Geva, *Bank Collections*).

<sup>2</sup> For the expansion of the money supply in the economy, see ch 10, section 3.4 above.

model for the payment system is made here; history has proven that any such prediction is futile.

However, while the future of deposit banking, as well as that of payment systems, may be shrouded in uncertainty, this is less so with respect to the overall relationship between deposit banking and a thriving non-cash payment system. So far as we can tell, the lesson from history is that a growing payment system is to be nurtured by healthy and successful deposit banking.

As well, history has demonstrated that there is good reason to believe that the durability of legal principles discussed in this book will lead to their continued evolution as the framework to govern future payment system developments. This is likely to be true even in an environment that does not encourage the growth of deposit banking. Indeed, aspects of funds transfers are governed by principles originating or derived from Islamic law as well as from the Jewish Talmud. For its part, the hostility of Islamic and Jewish laws to interest taking does not provide a welcoming environment for the growth of deposit banking. However, principles derived from these two systems, side by side with those derived from legal systems that encourage the growth of deposit banking, have been used as building blocks in the evolution of the law of funds transfers. This only proves the versatility and breadth of legal doctrine underlying the evolving law of payment and funds transfers.

## 2. PAYMENT SERVICES AND THEIR PROVIDERS

A person participating in the facilitation of payment between two parties may be referred to as a payment-service provider. In carrying out a part of the payment transaction the payment-service provider furnishes a payment service. Other than in the case of the physical delivery of money, including that of a direct cash payment between a payer and payee, a payment-service provider must act in a payment transaction as a paymaster, complying with the payer's instructions to make the payment. Acting for the payer, the paymaster either receives cash from him, or debits an account which the paymaster maintains for the payer. In addition, in a payment transaction, a payment-service provider may receive the payment for the payee, either in cash, or in the form of monetary value posted to an account. That payment-service provider may then either give cash to the payee, or credit an account which the payee maintains with him. Under some payment methods, the payee may be satisfied with the obligation of a paymaster, being the payment-service provider of the payer, and give the payer a discharge prior to receiving actual payment either in cash or in monetary value.

End parties to a payment transaction, that is, the payer and the payee, may be referred to as payment-service users. Accounts out of and into which payments are made can be on a card or any other device under the physical control of the payment-service user, in which case payment in e-money is involved.



As a rule, non-cash payment services are given in the form of the transmission of funds, namely a funds transfer, from the payer's account to that of the payee. Besides the payment-service providers of the end parties, a funds transfer may involve intermediaries, clearing facilities, and settlement agents, connecting all participants into a payment system. This section focuses on the payment-service providers at both ends of the payment transaction.

Funds transfers are either credit or debit transfers. Where the payer's instructions are communicated directly to the paymaster, acting as his payment-service provider, there is a credit transfer. Where the payer's instructions are communicated to the paymaster indirectly, namely via the payee, who in turn instructs his payment-service provider to collect money from the payer's account with the paymaster, there is a debit transfer. In the credit transfer, the payer's instructions communicated to the paymaster 'push' funds to the payee. In the debit transfer, the payee's communication to the paymaster (on the basis of the payer's authorization) via the payee's payment service provider 'pulls' or 'draws' funds from the payer.<sup>3</sup>

Usually, payment-service providers are deposit-taking institutions, namely, banks. As a financial activity, deposit taking or banking is the taking of deposits from the public and their use by the depositary for his own profit, usually by charging borrowers interest rates higher than those given to depositors. The connection between deposit banking and the existence of a non-cash payment system, facilitating the transfer of funds from one deposit to another, has been pointed out in this study on several occasions.<sup>4</sup> What follows is a brief historical review.

In a nutshell, the *trapezitai* of Ancient Greece were the first deposit-taking institutions providing non-cash payment services. Their successors were the *argentarii* in Ancient Rome. Similar institutions carried on business in Greco-Roman Egypt.<sup>5</sup> Subsequently, deposit banking surfaced in late-Medieval Continental Europe. Having been superseded by public banks that did not lend out of deposits, deposit and transfer banks in Europe lost ground.<sup>6</sup> Deposit banks reappeared in post-Medieval England in the institutional context and framework that is still recognizable today.<sup>7</sup>

A non-cash payment service has also been performed not out of deposits given for safekeeping but, rather, out of funds delivered to the service-provider for the purpose of executing a specific payment. The first to provide this service were the *coactores* in Ancient Rome who carried out this business in auctions. Other money-transmitters encountered in this study were *suftaj* issuers in the

<sup>3</sup> For a comprehensive discussion of points made in these opening paragraphs of section 2, see ch 1, section 4 above.

<sup>4</sup> See eg ch 4, section 1 and ch 6, section 1 above.

<sup>5</sup> See above, ch 3, respectively sections 3, 4, and 5. Note that in Greco-Roman Egypt, banks acted more as loan brokers than lenders in their own name. See above, ch 3, section 5, text around nn 148–50.

<sup>6</sup> See ch 8, section 2 above.

<sup>7</sup> See ch 10, sections 2 and 3 above.

Islamic lands in the early Medieval era. Subsequently, during the late Medieval era, large merchants, acting as exchange bankers, used the early bill of payment to transmit their own funds to a foreign market.<sup>8</sup> Bailees of money in Medieval England also appeared to act as money-transmitters.<sup>9</sup>

This scheme of payment services provided by deposit-taking banks and money-transmitters, whose roots are traced back to Antiquity and the Middle Ages, still exists in the present day. Moreover, then as now, an inherent risk in the operation of a payment service has been the creditworthiness, honesty and reliability of payment-service providers. Thus, during the execution of a payment transaction, funds are out of the control of the payer and the payee, but rather in the hands of payment-service providers, or intermediaries acting for the payment-service providers. Hence, the regulation of payment-service providers can be traced to Antiquity and, subsequently, to the Middle Ages.<sup>10</sup>

What has changed is the nature of institutional arrangements and technology. As to the former, stand-alone institutions came to be connected first bilaterally and then multilaterally, ultimately in the context of a pyramid headed by a central bank.<sup>11</sup> Local systems connected to form national and cross-border networks so as ultimately to create a global payment system. As for technology, there has been a shift from paper to electronic methods of initiation and processing.

A modern scheme for the provision and regulation of payment services set out below is from the European Union. Indeed, the scheme excludes paper-based systems, and does not provide for a comprehensive funds transfer or payment transactions law. At the same time, it is most extensive in covering selected aspects of all types of payment transactions initiated and processed electronically as well as in providing a framework for the licensing and regulation of payment-service providers. It is unique in its holistic approach towards 'payment services' and 'payment-service providers'. Even so, its features demonstrate continuity in the treatment of issues pertaining to the regulation of payment services and their providers.

In its proposal for a Directive on payment services in the internal market (hereafter: the Proposal),<sup>12</sup> the Commission of the European Communities (the

<sup>8</sup> See above respectively, ch 3, section 4, ch 6, section 3 and ch 8, section 3.

<sup>9</sup> See discussion in ch 9, section 2 above.

<sup>10</sup> See particularly for Ancient Rome and deposit banks in Medieval Europe, respectively discussed above in ch 3, section 4 and ch 8, section 2.

<sup>11</sup> This architecture and evolution is addressed in various parts of the study, particularly in chs 3, 5, 8 and 10 above.

<sup>12</sup> EC, *Implementing the Community Lisbon programme: Proposal for a Directive of the European Parliament and of the Council on payment services in the internal market and amending Directives 97/7/EC, 2000/12/EC and 2002/65/EC* (presented by the Commission) {SEC(2005) 1535}, COM (2005) 603 final; 2005/0245/COD (Brussels, 1.12.2005), [www.eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2005:0603:FIN:EN:HTML](http://www.eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2005:0603:FIN:EN:HTML) (hereafter: *Implementing the PSD*). Quotations in the text are from the Explanatory Memorandum, under 'Context of the Proposal', *ibid*, which further cites arts 47(2) and 95(1) of the EC Treaty as the legal basis for the proposal. The proposal was discussed by this author in B Geva, 'Recent International Developments in the Law of Negotiable Instruments and Payment and Settlement Systems' (2007), 42 *Texas International Law Journal* 685 at 712–25 (hereafter: Geva, 'Recent Developments').

Commission) purported to provide for 'a harmonised legal framework' designed to create 'a Single Payment Market where improved economies of scale and competition would help to reduce the cost of the payment system.' The Proposal was 'complemented by industry's initiative for a Single Euro Payment Area (SEPA), aimed at integrating national payment infrastructures and payment products for the euro-zone.' The Proposal was thus designed to 'establish a common framework for the Community payments market creating the conditions for integration and rationalisation of national payment systems.' It focused on electronic payments, and was designed to 'leave maximum room for self-regulation of industry.'<sup>13</sup>

As ultimately adopted, the Directive on payment services in the internal market, often colloquially referred to as 'the Payment Services Directive' (hereafter: the PSD)<sup>14</sup> implemented this vision. Its scope is stated in article 2(1) to 'apply to payment services provided within the Community', that is, both national or domestic and cross-border. The PSD purports to govern the business activity of carrying out payments through the services of one or two payment services providers,<sup>15</sup> each acting for a 'payment service user';<sup>16</sup> the latter being either the payer or the payee, who may be either a natural or a legal person.<sup>17</sup> The payment service could be carried out for either a consumer or a business transaction, and for whatever amount.

According to article 4(9), 'payment service provider' means 'bodies referred to in Article 1(1) and legal and natural persons benefiting from the waiver under Article 26.'<sup>18</sup> Article 1(1) enumerates 'six categories of payment service provider':

- (a) credit institutions within the meaning of Article 4(1)(a) of Directive 2006/48/EC, those being effectively deposit-taking institutions or commercial banks;
- (b) electronic money institutions within the meaning of Article 1(3)(a) of Directive 2000/46/EC;
- (c) post office giro institutions which are entitled under national law to provide payment services;
- (d) payment institutions within the meaning of this PSD;

<sup>13</sup> *Implementing the PSD, ibid* in the Explanatory Memorandum, under 'Legal Elements of the Proposal'. For SEPA, see eg European Central Bank, *Single Euro Payments Area (SEPA) From Concept to Reality, Fifth Progress Report* (Frankfurt: July 2007).

<sup>14</sup> EC, *Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC*, [2007] O.J. L 319/1, [www.eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:319:0001:01:EN:HTML](http://www.eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:319:0001:01:EN:HTML) (hereafter: the PSD). Unless indicated otherwise, statutory provisions cited throughout this section are from the PSD.

<sup>15</sup> Defined in art 4(9) as discussed further immediately below.

<sup>16</sup> Defined in art 4(10) to mean 'a natural or legal person making use of a payment service in the capacity of either payer or payee, or both'.

<sup>17</sup> See definitions of 'payer' and 'payee', respectively in art 4(7) and (8).

<sup>18</sup> The 'waiver under Article 26' is a waiver to the authorization requirements of 'payment institutions' making the fourth category listed in art 1(1) and will be discussed below as part of the discussion on payment institutions forming that fourth category.

- (e) the European Central Bank and national central banks when not acting in their capacity as monetary authorities or other public authorities; and
- (f) Member States or their regional or local authorities when not acting in their capacity as public authorities.

Chapter 1 of Title II deals with the fourth category. It establishes a legal framework for the authorization under a single licence for all businesses providing payment services that are not connected to taking deposits or issuing e-money, and regulated under existing EU Directives,<sup>19</sup> under which they require a licence.<sup>20</sup> Authorization by a competent national authority of a Member State is to be valid in all Member States.<sup>21</sup>

Two types of payment-service providers do not fall within the ambit of this fourth category. First excluded are credit and electronic money institutions licensed other than under the PSD. Credit institutions are banks; they are authorized to provide payment services under the EU Banking Directive.<sup>22</sup> Electronic money institutions are specialized money-transmitters, executing payments in e-money, that is, value loaded on a device under the physical control of the payer or the payee, such as a card, mobile phone, or computer software, rather than in value credited and debited to regular bank accounts.<sup>23</sup> However, in addition to issuing e-money, electronic money institutions may engage in all activities allowed for 'payment institutions',<sup>24</sup> including 'the provision of [all] payment services listed in the Annex to the [PSD]';<sup>25</sup> they may also engage in the granting of short-term credit related to certain payment services, albeit not from 'funds received in exchange for electronic money'.<sup>26</sup> Second, post

<sup>19</sup> EC, *Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions* (recast) [2006] O.J. L 177/1 (hereafter: the Banking Directive); and EC, *Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions* [2000] O.J. L 275/39 (hereafter: Directive 2000/46/EC), respectively. The latter has been superseded by EC, *Directive 2009/110/EC of the European Parliament and of the Council of September 16 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC* [2009] O.J. L 267/7 (hereafter: the E-money Directive).

<sup>20</sup> To a large extent, the US parallel will be Article 2 of the *Uniform Money Services Act* (2000) (hereafter: UMSA), developed by the National Conference of Commissioners on Uniform State Laws. See [www.law.upenn.edu/bll/archives/ulc/moneyserv/UMSA2004Final.htm](http://www.law.upenn.edu/bll/archives/ulc/moneyserv/UMSA2004Final.htm) covering money transmission licences.

<sup>21</sup> Art 10(9). For some procedural aspects, see art 25.

<sup>22</sup> Under paras 4 and 5 of Annex I of the Banking Directive, above n 19, '[m]oney transmission services' and '[i]ssuing and administering means of payment (eg credit cards, travellers' cheques and bankers' drafts)' are activities permitted to a 'credit institution' defined in art 4(1) to mean 'an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account'.

<sup>23</sup> Conceptually, electronic money institutions could have been treated as payment institutions as under the UMSA, above n 20, in the US. I suppose that they were not included in the PSD because they had been covered by the earlier E-money Directive.

<sup>24</sup> See art 6 of the E-money Directive, above n 19. These activities are set out in text around n 41 below.

<sup>25</sup> E-money Directive, *ibid* at art 6(1)(a).

<sup>26</sup> *Ibid* at art 6(1)(b).

office giro institutions, central banks, and Member States, none of which require to be licensed in order to provide and execute payment services throughout the Community, are not included in this fourth category.

Payment-service providers falling into this fourth residual category governed by Title II to the PSD are referred to in the Preamble and the headnote to Chapter 1 of Title II as ‘payment institutions’.<sup>27</sup> Title II is designed to ‘create a level-playing field, instil more competition in national markets and reflect market developments in recent years, triggering market entry of a new generation of providers.’ To that end, Title II is further designed to harmonize market access, also with a view to facilitating ‘the gradual migration of . . . providers from the unofficial economy to the official sector.’<sup>28</sup> In the language of Paragraph 11 of the Preamble:

The conditions for granting and maintaining authorisation as payment institutions should include prudential requirements proportionate to the operational and financial risks faced by such bodies in the course of their business. In this connection, there is a need for a sound regime of initial capital combined with ongoing capital which could be elaborated in a more sophisticated way in due course depending on the needs of the market. . . . The requirements for the payment institutions should reflect the fact that payment institutions engage in more specialised and limited activities, thus generating risks that are narrower and easier to monitor and control than those that arise across the broader spectrum of activities of [deposit-taking] credit institutions. In particular, payment institutions should be prohibited from accepting deposits from users and permitted to use funds received from users only for rendering payment services.<sup>29</sup> Provision should be made for client funds to be kept separate from the payment institution’s funds for other business activities.<sup>30</sup> Payment institutions should also be made subject to effective anti-money laundering and anti-terrorist financing requirements.

For small institutions, authorization requirements may be compromised. Thus, to prevent the forcing out into the black economy of those unable to meet all conditions for authorization as payment institutions, provision is made for the registration ‘of payment institutions while not applying all or part of the conditions for authorisation’, but only as long as derogation is limited to the provision of payment services within the Member State of registration and is ‘subject to strict requirements relating to the volume of payment transactions’.<sup>31</sup>

This waiver is implemented by article 26, which permits Member States to waive the application of all or part of the ‘procedure and conditions’ set out for

<sup>27</sup> Defined in art 4(4) to mean ‘a legal person that has been granted authorisation in accordance with Article 10 to provide and execute payment services throughout the Community’.

<sup>28</sup> *Implementing the PSD*, above n 12, in the Explanatory Memorandum, under ‘Legal Elements of the Proposal’.

<sup>29</sup> To that end, art 16(2) clarifies that ‘funds received by payment institutions from payment service users with a view to the provision of payment services shall not constitute a deposit or other repayable funds within the meaning of Article 5 of Directive 2006/48/EC, or electronic money within the meaning of Article 1(3) of Directive 2000/46/EC.’ The former Directive governs deposit taking by credit institutions and the latter governs electronic money institutions.

<sup>30</sup> A point codified in art 9. See also art 10(5).

<sup>31</sup> Preamble, para 15.

the authorization of payment institutions. Enumerated exceptions that cannot be waived relate to the designation of competent authorities for the authorization and prudential regulation of payment institutions under article 20; professional secrecy under article 22; access to courts under article 23; and the exchange of information among competent authorities under article 24. This waiver may benefit only payment institutions for which ‘the average of the preceding twelve months’ total amount of payment transactions executed . . . does not exceed EUR 3 million per month’ and whose managers have not been convicted of financial crimes. The activities of payment institutions benefiting from this waiver are restricted to the territory of the Member State that conferred on them the benefit of the waiver.

Specific provisions deal with capital requirements;<sup>32</sup> the safeguarding by segregation of funds placed for payment transactions;<sup>33</sup> the authorization process, the maintenance as well as the withdrawal of authorization, and the registration of authorized payment institutions;<sup>34</sup> compliance with accounting and statutory audit requirements;<sup>35</sup> the use of branches and third parties by payment institutions;<sup>36</sup> record-keeping requirements;<sup>37</sup> and professional secrecy.<sup>38</sup> They also provide for the designation of competent authorities for prudential regulation and supervision as well as their activities and exchange of information,<sup>39</sup> and right to apply to the courts.<sup>40</sup>

Activities permitted to payment institutions are enumerated in article 16(1). All such activities are governed by the PSD even when they are performed by ‘payment-service providers’ other than those licensed under the PSD.<sup>41</sup> Activities consist of (i) the provision of payment services; (ii) the provision of operational and related ancillary services such as the guaranteeing of the execution of payment transactions, foreign exchange services, safekeeping activities,<sup>41.1</sup> and storage and processing of data; (iii) operating payment systems; and (iv) business activities other than the provision of payment services, having regard to applicable Community and national law.<sup>42</sup>

‘Payment services’ to which the PSD applies under article 2(1) are defined in article 4(3) to mean business activities listed in the Annex. ‘Payment services’

<sup>32</sup> Arts 6–8 providing for initial capital, own funds, and two alternative methods for calculation of own funds.

<sup>33</sup> Art 9.

<sup>34</sup> Arts 5 and 10–14.

<sup>35</sup> Art 15.

<sup>36</sup> Arts 17–18.

<sup>37</sup> Art 19.

<sup>38</sup> Art 22.

<sup>39</sup> Arts 20–21 and 24.

<sup>40</sup> Art 23.

<sup>41</sup> ‘Payment-service providers’ are listed in text that follows n 18 above.

<sup>41.1</sup> Certainly, this must be taken to refer to the provision of safety box services and not to the safekeeping of money in the form of deposit taking.

<sup>42</sup> The fourth category replaced art 10(3) of the Proposal, under which permitted activities ‘shall not be restricted to payment services, having regard to the applicable national and Community law’. *Implementing the PSD*, above n 12.

listed in the Annex<sup>43</sup> are cash deposits and withdrawals in and from payment accounts;<sup>44</sup> execution of payment transactions<sup>45</sup> in funds<sup>46</sup> held on deposit in a payment account; execution of direct debits; execution of payment transactions through a payment card (or a similar device); execution of credit transfers (including standing orders); execution of payment transactions in funds covered by a credit line; execution of direct debits ('including one-off direct debits');<sup>47</sup> issuing of payment cards; execution of payment transactions in e-money;<sup>48</sup> money remittance services in funds accepted for the sole purpose of carrying out the payment transaction;<sup>49</sup> and the '[e]xecution of payment transactions where the consent of the payer to execute a payment transaction is given by means of any telecommunication, digital or IT device'.

Article 3 deals with the outer limits of the PSD. Thereunder, cash payments made 'directly from the payer to the payee, without any intermediary intervention';<sup>50</sup> professional physical transport of banknotes and coins including their collection and delivery; payment transactions consisting of the non-professional cash collection and delivery within the framework of a non-profit

<sup>43</sup> The list is, however, quite disorganized and repetitive; eg, three items (card payments, direct debits and credit transfers) are enumerated separately according to whether they are used in connection with a 'payment account' or credit line.

<sup>44</sup> Under art 4(14), 'payment account' is defined to mean 'an account held in the name of one or more payment service users which is used for the execution of payment transactions'. The Proposal required the account to be used 'exclusively' for the execution of payment transactions, which was unnecessarily restrictive.

<sup>45</sup> 'Payment transaction' is defined in art 4(5) to mean 'an act, initiated by the payer or by the payee, of placing, transferring or withdrawing funds, irrespective of any underlying obligations between the payer and the payee'.

<sup>46</sup> 'Funds' are defined in art 4(15) to mean 'banknotes and coins, scriptural money and electronic money as defined in Article 1(3)(b) of Directive 2000/46/EC'.

<sup>47</sup> 'Direct debit' is defined in art 4(28) to mean 'a payment service for debiting a payer's payment account, where a payment transaction is initiated by the payee on the basis of the payer's consent given to the payee, to the payee's payment service provider or to the payer's own payment service provider'. 'Credit transfers' is not defined, which is unfortunate. The same applies to 'payment card.' Cf art 4(23) defining 'payment instrument' to mean 'any personalised device(s) and/or set of procedures agreed between the payment service user and the payment service provider and used by the payment service user in order to initiate a payment order'. According to art 4(16), 'payment order' means 'any instruction by a payer or payee to his payment service provider requesting the execution of a payment transaction'.

<sup>48</sup> According to art 1(3)(b) of Directive 2000/46/EC, above n 19, 'electronic money' is defined to mean 'monetary value as represented by a claim on the issuer which is: (i) stored on an electronic device; (ii) issued on receipt of funds of an amount not less in value than the monetary value issued; (iii) accepted as means of payment by undertakings other than the issuer.'

<sup>49</sup> Art 4(13) defines 'money remittance' to mean 'a payment service where funds are received from a payer, without any payment accounts being created in the name of the payer or the payee, for the sole purpose of transferring a corresponding amount to a payee or to another payment service provider acting on behalf of the payee, and/or where such funds are received on behalf of and made available to the payee.'

<sup>50</sup> The quoted language from art 3(a) did not appear in the Proposal and, in my view, is unduly restrictive. Any physical delivery, whether direct or through an intermediary ought to have been excluded, as is in fact acknowledged in para 19 of the Preamble, reproduced in n 55 below.



or charitable activity;<sup>51</sup> payment transactions through a commercial agent<sup>52</sup> authorized to negotiate or conclude the sale or purchase of goods or services on behalf of the payer or the payee; as well as certain cash refunds,<sup>53</sup> are specifically excluded.

Also excluded from the coverage of the PSD under article 3 are currency exchange transactions in the form of cash-to-cash operations;<sup>54</sup> paper cheques, drafts (bills of exchange), vouchers, traveller's cheques and postal money orders;<sup>55</sup> payment transactions carried out within a payment or securities clearing and settlement system; payments transactions related to securities asset servicing; payment processing services; payment by instruments which are not redeemable within a limited network of affiliated service providers; payment transactions executed by means of a mobile telephone or any other digital or IT device where 'the telecommunication, IT system or network operator' acts as the supplier of 'goods or services . . . to be used through a telecommunication, digital or IT device';<sup>56</sup> payment transactions carried out between payment-service providers for their own account as well as between entities belonging to the same corporate group<sup>57</sup> such as subsidiaries; and 'services by providers to withdraw cash by means of automated teller machines acting on behalf of one or more card issuers, which are not a party to the framework contract'<sup>57.1</sup> with the customer withdrawing money from a payment account, on condition that these providers do not conduct other payment services as listed in the Annex.<sup>58</sup>

<sup>51</sup> These distinctions between 'professional' and 'non-professional' as well as 'non-profit and charitable activity' and other (presumably for profit or business) activity, do not strike me as necessary or convincing. It would have been adequate to exclude all cash payments and collections.

<sup>52</sup> 'Agent' is defined in art 4(22) to mean 'a natural or legal person which acts on behalf of a payment institution in providing payment services'. This is however not the sense in which the term is used in art 3(b). For 'payment institution' see text and n 27 above.

<sup>53</sup> Under art 3(e), what is excluded are 'services where cash is provided by the payee to the payer as part of a payment transaction following an explicit request by the payment service user just before the execution of the payment transaction through a payment for the purchase of goods or services'.

<sup>54</sup> Or, in the language of art 3(f), 'cash-to-cash operations, where the funds are not held on a payment account'.

<sup>55</sup> Art 3(e) of the Proposal also excluded promissory notes. On the other hand, drafts or bills of exchange were not enumerated in the Proposal. Paragraph 19 of the Preamble explains that '[t]his Directive should apply neither to payment transactions made in cash, since a single payments market for cash already exists nor to payment transactions based on paper cheques since, by their nature, they cannot be processed as efficiently as other means of payment. Good practice in this area should, however, be based on the principles set out in this Directive'.

<sup>56</sup> Art 3(1).

<sup>57</sup> Defined in art 4(30) to mean 'a group of undertakings, which consists of a parent undertaking, its subsidiaries and the entities in which the parent undertaking or its subsidiaries have a holding as well as undertakings linked to each other by a relationship referred to in Article 12(1) of Directive 83/349/EEC.'

<sup>57.1</sup> Under art 4(12), 'framework contract' is defined to mean 'a payment service contract which governs the future execution of individual and successive payment transactions and which may contain the obligation and conditions for setting up a payment account.'

<sup>58</sup> This language of art 3(o) as quoted in full in the text above is grammatically obscure and hence its meaning is not immediately discernible.

The rationale for the drafters to enumerate separate payment transactions rather than to provide for the broad principle of coverage for debit and credit transfers, even if only those initiated electronically, is not all that clear and is open to criticism. At the same time, this broad principle may be deduced from the extensive list. In the final analysis, while, regrettably, not all legal aspects of funds transfers are covered,<sup>59</sup> in terms of institutional and transactional coverage, building on the past, the PSD is a good model for the future.

### 3. THE BANK DEPOSIT

Money placed in a demand deposit is available to the depositor; and yet, through bank lending, it is also available to the borrower from a bank, whether or not it is re-deposited in it. This ‘double disposition’ of money deposited in a bank expands the ‘money supply’ in the economy and underlies ‘commercial bank money’;<sup>60</sup> and yet it perplexes legal theorists who, in discussing the legal nature of the bank deposit, have endeavoured to capture this aspect.<sup>61</sup> However, in the final analysis, towards the depositor, the bank deposit simply creates a right in personam against the depositary and effectively forfeits the right in rem in the actual coins and banknotes the depositor had in them prior to the deposit.<sup>62</sup> This feature, shared by both common and civil law jurisdictions, evolved gradually. It is derived from the nature of banknotes and coins as fungible items of property; and yet, to a different degree in each legal system, development has been hindered by conceptions of bailment or deposit for safekeeping.

In Roman law,<sup>63</sup> money deposited gives rise to the irregular deposit (or the *depositum irregulare*); this is the deposit of an object, subject to a condition of restitution in genre, namely in equivalent amount, and not in specie. It entails the transfer of ownership in the object of the transaction to the depositary, and not merely of physical control or right of detention. At the same time, the irregular deposit was treated as a sub-category of a deposit or bailment, so that the

<sup>59</sup> See eg B Geva, ‘The Harmonization of Payment Services Law in Europe and Uniform and Federal Funds Transfer Legislation in the USA: Which is a Better Model for Reform?’ (2009), 4 *Revue Européenne de Droit Bancaire et Financier/European Banking and Financial Law Journal* 699 (an earlier version was published in MR Farina, V Santoro, AA Sciarone and O Troiano (eds), *Armonizzazione Europa Del Servizi Di Pagamento E Attuazione Della Direttiva 2007/64/CE*, 48 *Il Diritto della Banca e della Borsa*, Study Dbattiti (Milano: Giuffrè Editore, 2009)); and B Geva, ‘Global and Cross-Border Credit Transfers: The Role of Legislation in Addressing Legal Risk for Participants’, in M Giovanoli and D Devos (eds), *International Monetary And Financial Law: The Global Crisis* (New York: Oxford University Press, 2010) 545.

<sup>60</sup> For the ‘money supply’ as consisting of deposits in commercial banks and currency (banknotes and coins) in circulation, see above, ch 1, text around n 61, and ch 10, sections 3.3 and 3.4.

<sup>61</sup> Particularly, see R Ben-Oliel, *The Juridical Nature of the Bank-Depositor Relationship* (Doctoral Thesis, Hebrew University of Jerusalem, 1977) [unpublished] [in English].

<sup>62</sup> See eg K Laurinavičius, ‘The Legal Nature of Bank Deposits’ (2006), 31 *Review of Central and East European Law* 291.

<sup>63</sup> See ch 5, section 2, text around n 14 and discussion that follows.

starting point for discussing the depositary's liability was as if he were a custodian for safekeeping.

For its part, as discussed above in chapter seven, section 2.1, under the Talmud, the deposit of money, even in an open bag, was for safekeeping, so as to be returned in specie. The Talmud gives the depositary the right to use money on deposit only in very limited circumstances; when they occur, the depositary becomes liable for the amount so used.<sup>64</sup> At the same time, the Talmud does not permit a depositary for safekeeping to mix money deposited by different depositors as well as with his own money;<sup>65</sup> hence, the Talmud has not developed a parallel to the Roman irregular deposit.<sup>66</sup> Thus, in principle, a depositary of money under the Talmud is treated like a bailee for safekeeping of a specific chattel.

The power of the depositary not only to mix deposited money but also to use it at his unfettered discretion, exclusively for his own profit, originated in the English common law. However, this power and right has not prejudiced, and has co-existed with, the depositary's absolute obligation to the depositor for the sum of the deposit (possibly with interest, if and as so agreed). Thus, as discussed above in chapter nine,<sup>67</sup> in English Medieval common law, a claim by a 'bailor' for the return of money delivered to a 'bailee', who was not required to segregate it, was in Debt.<sup>68</sup> Ultimately,<sup>69</sup> this led to the characterization of the relationship between a banker and customer in regard to deposited money as that of a debtor and creditor.<sup>70</sup>

The link is supplied by *Bretton v Barnet* (1599).<sup>71</sup> The case dealt with the situation where '[a] man delivers money to J.S. to be redelivered to him when he

<sup>64</sup> Money returned not in specie, whether to a lender, a depositor, or an investor, must however be of a quality consistent with that originally given. See eg Talmud, *Bava Metzia*, at 69A (for an investment), and cf Talmud, *Bava Kamma* at 97A–97B (for a loan; particularly see difference of opinion between Rashi (at 97B D'H 'Noten lo') and Tosafot (at 97B D'H 'Hamalveh') in the case of a coin that became disqualified).

<sup>65</sup> Prohibition to mix deposits appears to be in line with a similar practice for grain deposits in Ancient Mesopotamia, as discussed by R Bogaert, *Les Origines Antiques de la Banque de Dépôt* (Leyde: AW Sijthoff, 1966) at 59, 84, fn 236, 99 text and nn 311–13. However, for the mixture of money deposited by several people for the purpose of purchasing goods for each of them, in which case, whatever is purchased – even for one of the depositors with the sum deposited by him – belongs to them all jointly, see Talmud, *Bava Metzia* at 74A.

<sup>66</sup> This is so notwithstanding A Gulak, 'The Moneychanger's Business According to Talmudic Law' (1931), 2 *Tarbitz* 154 at 157 [in Hebrew]. Gulak claims that such a parallel exists under the Talmud in circumstances where the depositary is allowed to use the deposited money. However, the depositary's right to use deposited money under the Roman law irregular deposit was premised on the right to mix it, which does not appear to be recognized in the Talmud.

<sup>67</sup> See above, ch 9, section 2.

<sup>68</sup> This goes back to *Anon* (1368) Y.B. Pasch. 41 Ed. III, f.10, pl. 5, in CHS Fifoot, *History and Sources of the Common Law: Tort and Contract* (London: Stevens & Sons, 1949) at 285 (hereafter: *Fifoot, History*), as confirmed by *Core's Case* (1537), Dyer, 20a, 73 E.R. 42, Fifoot, *ibid* at 285.

<sup>69</sup> See above, ch 9, section 5, text and nn 281–85.

<sup>70</sup> See text at nn 81–87 below.

<sup>71</sup> Owen. 86, 74 E.R. 918.

should be required: which J.S. refused.<sup>72</sup> The plaintiff-bailor brought a Debt action against JS. Particular emphasis was given to the distinction between Debt and Detinue; namely, between an action for a sum of money, and an action for the return of specific coins.<sup>73</sup> Explicitly citing a case holding that where 'a man delivers money to another to buy certain things for him, and he does not buy them, the party may bring an action of debt',<sup>74</sup> the court held for the plaintiff. The judges were not concerned with the question of whether the bailee had been free to use the money. Rather, they agreed that 'if money be delivered, it cannot be known, and therefore the property is altered.'<sup>75</sup> Stated otherwise, the bailee's freedom to 'make an exchange'<sup>76</sup> of the money deposited with him, and pay the depositor a sum equivalent thereto, had given adequate grounds for Debt.

In any event, as discussed above in chapter ten,<sup>77</sup> during the seventeenth century, by lending to others the money delivered to him, the goldsmith, as a depository of money, had transformed the nature of his business. Having before then acted as a custodian of safekeeping,<sup>78</sup> he came to accept deposits with full authority to make use of deposited money by lending it to others; thus he became a banker.<sup>79</sup> Being free to use the money, he truly became a borrower from the customer-depositor so as to be liable to him in Debt.<sup>80</sup>

It was, however, only in the course of the nineteenth century that the process of the characterization of the bank deposit as a loan, so as to be owed by the banker to the customer as a debt on a loan, reached its logical conclusion. The landmark case is *Foley v Hill* (1848).<sup>81</sup> In that case, the House of Lords dealt with the 'common position of a banker . . . receiving money from his customer

<sup>72</sup> *Ibid.* Notwithstanding the ambiguity in this statement of facts, the report unequivocally suggests (and so it was understood by AWB Simpson, *A History of the Common Law of Contract: The Rise of the Action of Assumpsit* (Oxford: Clarendon Press, 1975) at 183) that the case dealt with the deposit of money for safekeeping, and not with a demand loan. It is unlikely that a borrower's Debt liability would have been disputed in 1599.

<sup>73</sup> For this distinction see above, first paragraph in ch 9, section 2, and the discussion that follows.

<sup>74</sup> *Cf Core's Case* (1537), above n 68.

<sup>75</sup> *Bretton v Barnet* (1599), above n 71.

<sup>76</sup> *Core's Case* (1537), above n 68 at 22a (Dyer), 46 (E.R.), 287 (Fifoot).

<sup>77</sup> See ch 10, section 2.2, paragraph containing nn 23–35 above.

<sup>78</sup> It is likely that he was never a bailee of specific coins. A custodian of money for safekeeping was not allowed to use the money, but inasmuch as he was not required to return to each depositor the specific coins originally delivered to him for safekeeping, or to keep them separately, he was not liable in Detinue. The nature of the custodian's liability to the depositor, whether in Debt or Account, 'was never really settled in medieval law.' Simpson, above n 72 at 183. See ch 9, text around n 35 above. But see A Feavearyear, *The Pound Sterling – A History of English Money*, 2nd edn by EV Morgan (Oxford: Clarendon Press, 1963) at 102 speaking of the goldsmith as a custodian of money acting 'just as a modern safe-deposit company would do' today, which suggests physical segregation of money deposited by each depositor.

<sup>79</sup> See eg RD Richards, *The Early History of Banking in England* (New York: AM Kelley, 1965, reprint of 1929 edition) at 37.

<sup>80</sup> For Debt on a loan, see ch 9, section 2, text at n 20 above.

<sup>81</sup> (1848), 2 H.L.C. 28, 9 E.R. 1002 (H.L.). A slightly earlier authority is *Pott v Clegg* (1847), 16 M&W 321, 153 E.R. 1212.

on condition of paying it back when asked'.<sup>82</sup> Holding that 'the banker is not an agent or factor, but [rather] he is a debtor',<sup>83</sup> Lord Cottenham spoke of the banker's right to mix and use money deposited with him, subject to a repayment obligation of an equivalent sum, either with or without interest:

Money, when paid into a bank, ceases altogether to be the money of the [customer]; . . . it is then the money of the banker, who is bound to return an equivalent by paying a similar sum to that deposited with him when he is asked for it. The money paid into the banker's [*sic*], is money known by the [customer] to be placed there for the purpose of being under the control of the banker; it is then the banker's money; he is known to deal with it as his own; he makes what profit of it he can, which profit he retains to himself, paying back only the principal . . . or the principal and a small rate of interest.<sup>84</sup>

Stated otherwise:

The money placed in the custody of the banker is, to all intents and purposes, the money of the banker, to do with it as he pleases; he is guilty of no breach of trust in employing it; he is not answerable to the [customer] if he puts it into jeopardy, if he engages in a hazardous speculation; he is not bound to keep it or deal with it as the property of his [customer], but he is of course answerable for the amount, because he has contracted, having received that money, to repay to the [customer], when demanded, a sum equivalent to that paid into his hands.<sup>85</sup>

In his concurring judgment, Lord Brougham pointed out that 'even a banker who does not pay interest could not possibly carry on his trade if he were to hold the money, and to pay it back, as a mere depositary'. In his view, it thus follows, a banker receives the deposit of money 'to the knowledge of his customer, for the *express purpose* of using it as his own' (emphasis added).<sup>86</sup> The inevitable conclusion is, then, that in his trade, a banker becomes a 'debtor to the person who has *lent* or deposited with him the money to use as his own' (emphasis added).<sup>87</sup>

The analysis of the debtor and creditor relationship between the banker and customer was subsequently refined in *Joachimson v Swiss Bank Corp* (1921).<sup>88</sup> The court acknowledged that an amount held by the banker for the customer on deposit forms a debt owing and accruing from the former to the latter. As such, it is garnishable by the customer's creditors. At the same time, in the absence of a demand properly made by the customer at the branch holding the account, the debt is not presently payable so that the banker does not incur liability for its payment.<sup>89</sup>

<sup>82</sup> *Foley v Hill*, *ibid* at 43 (H.L.C.), 1008 (E.R.).

<sup>83</sup> *Ibid* at 37 (H.L.C.), 1006 (E.R.).

<sup>84</sup> *Ibid* at 36 (H.L.C.), 1005 (E.R.).

<sup>85</sup> *Ibid* at 36–37 (H.L.C.), 1005–06 (E.R.).

<sup>86</sup> *Ibid* at 43–44 (H.L.C.), 1008 (E.R.).

<sup>87</sup> *Ibid.* at 44 (H.L.C.), 1008 (E.R.).

<sup>88</sup> [1921] 3 K.B. 110 (C.A.).

<sup>89</sup> For the demand made at the branch holding the account triggering the banker's liability at that place, see eg *Libyan Arab Foreign Bank v Bankers Trust Co* [1988] 1 Lloyd's Rep. 259, (1989) 3 All E.R. 252 (Q.B.).

As further highlighted above in chapter nine,<sup>90</sup> in allowing the bailor/depositor to sue in Debt, English common law bypassed difficulties encountered both in Roman and Talmudic laws. Thus, as we saw, both Roman law<sup>91</sup> and the Talmud<sup>92</sup> started their analysis of the money depositor/bailor's remedy by viewing the depositary/bailee of money for safekeeping as a custodian of chattels; they thus made him liable to the bailor on a remedy usually available against a bailee for safekeeping for the return of a specific chattel. To bridge between the right to mix money and liability for the return of a specific chattel, Roman law invented the 'irregular deposit', so as ultimately to fasten on the depositary/bailee liability akin to that of a borrower. For its part, by reference to the liability of a custodian for safekeeping of a specific chattel, as pointed out above in chapter seven, section 2.1, Talmudic law imposed liability on a custodian who was allowed to mix the money; it imposed liability even more strictly on a custodian who actually used the deposited money. However, in Talmudic law, it is only the custodian who actually used the money who became liable as a borrower.

In contrast to both legal systems, and only on the basis of the bailee's right to mix the money, and not necessarily to use it, English common law imposed on the bailee of money Debt liability, as if the bailee was a borrower. This conclusion was reached in English common law without the entanglement with the regime governing the liability of a custodian of a specific chattel, as was the case in both Talmudic and Roman law. Indeed, as against the bailee of money, English common law did not hesitate between Detinue and Debt, viz between a remedy for the recovery of a specific chattel and that for the recovery of a specific sum of money. Rather, English common law hesitated between two monetary claims, viz Account and Debt. On this point it improved on the Talmudic solution; it went even beyond Roman law in bypassing altogether the category of the irregular deposit, and thus facilitated an easy route to the characterization of the bank deposit as a loan.

Most Civil Codes<sup>93</sup> regard the bank deposit as an irregular deposit. They thus inherited the ambiguity originating in Roman law and varying as to the categorization of the transaction, particularly as to whether it is a subcategory of a

<sup>90</sup> See concluding paragraphs of ch 9, section 2 above.

<sup>91</sup> For a discussion on Roman law on this point, on which the balance of this paragraph draws, see ch 5, section 2 (particularly text as of n 14 to the end of the section).

<sup>92</sup> For a discussion on Talmudic law on this point, on which the balance of this paragraph draws, see ch 7, section 2.1.

<sup>93</sup> In this chapter, quotes of statutory provisions in English are from *The German Civil Code*, Revised Edition translated with an Introduction by SL Goren, (Littleton, Colo: Fred B Rothman & Co, 1994); *The Civil Code of Japan* (trans) (Tokyo: Ministry of Justice, 1972); *The Italian Civil Code*, trans M Beltramo, GE Longo and JH Merryman (Dobbs Ferry, NY: Oceana, 1966) Book IV Obligations (1991); *Swiss Code of Obligations*, English Translation of the Official Text, vol I: Contract Law (Zurich: Swiss-American Chamber of Commerce, 2008); *Code Civil du Praticien*, *Code Civil du Québec*, version bilingue (Montreal: DACFO, 1995); and *The French Civil Code Revised Edition* (as amended to 1 July 1994), trans JH Crabb (Littleton, Colo: Fred B Rothman & Co, 1995). 'Civil codes' collectively referred to hereafter refer to all of these codes.

deposit or a money loan. Occasionally, however, particularly in civil law jurisdictions where the irregular deposit is not provided for by statute, such as France and Quebec, proponents of the loan classification reject altogether even the position that the bank deposit is an irregular deposit.<sup>94</sup>

A few principal statutory models in civil law jurisdictions should be noted:

1. The irregular deposit is dealt with in the *Swiss* Code of Obligations (CO) in CO article 481 as the deposit of fungible goods. The provision is located among those governing bailment (CO articles 472–491). Under CO article 481, a depositary who agrees, whether expressly or by implication, to return a sum of money and not money in specie, becomes entitled to any profit and bears all risks. That is, he becomes strictly liable to pay the agreed sum. Such an agreement is presumed to exist whenever money is given in an open unsealed bag. No application of the provisions governing money loans is specifically mentioned. It is, however, disputed in doctrine whether the bank deposit should be classified as a loan for consumption (governed in Switzerland by CO articles 312–318).<sup>95</sup> It should be noted that under CO article 481, with respect to fungibles other than money, an authorization as to the depositary's right of disposition (that is, the right to use) must be expressly given. Moreover, under CO article 484, unless specifically authorized, a warehouseman is not allowed even to mix fungible things given to his custody. Whenever a mixture occurs, each depositor has a proportional proprietary right in the entire mixture. It appears that the depositary of money has both the right to mix and to use, and that therefore he incurs all risks. This is in line with the consensus underlying the irregular deposit in civil law; yet, the attention given to the distinction between the right to mix and to use, though with respect to chattels other than money, is noteworthy.
2. In both *Germany* and *Japan* the irregular deposit is dealt with, as in Switzerland, in the context of the general deposit provisions. However, in both civil codes, the irregular deposit is explicitly classified as a loan for consumption. In Germany, under §700 of the Civil Code (BGB), '[i]f fungibles are deposited in such manner that the ownership is to pass to the depositary, and he is to be bound to return things of the same kind, quality and quantity, the provisions relating to loan for consumption apply.' Furthermore, '[i]f the depositor permits the depositary to consume deposited fungibles, the provisions relating to loan for consumption apply as from the time at which the depositary takes over the things.' Yet, classification as a loan for consumption is not for all intents and purposes: in case of doubt, 'the time and place of return is determined . . . according to the provisions relating to the contract of deposit.' Similarly, in Japan, under article 666 of the Civil Code (CC), 'the provisions relating to loans for consumption shall apply with

<sup>94</sup> A strong proponent of this view is GVV Nicholls, 'The Legal Nature of Bank Deposits in the Province of Quebec' (Part I) (1935), 13 *Canadian Bar Review* 635 at 644–54.

<sup>95</sup> See, in general, D Guggenheim, *Les Contrats de la Pratique Bancaire Suisse*, 2nd edn (Geneva: Georg, 1989) at 77–84.



necessary modifications' to the case where the depositary is allowed to consume the deposited thing. However, 'if no time for . . . return has been fixed by the contract', the depositor 'may at any time' demand the return of the deposited thing. In Germany, loans for consumption are governed by BGB §§607–610. In Japan, loans for consumption are governed by CC articles 587–592.

3. In *Italy*, article 1782 of the Civil Code (CC), located in the deposit chapter, defines the irregular deposit as 'the deposit . . . of an amount of money or other fungible things [of which] the depositary is authorized to make use.' Under CC article 1782, the depositary 'acquires ownership [of the money or things deposited]<sup>96</sup> and is bound to return an equal number of things of the same kind and quality.' As in Germany and Japan, 'the rules applicable to loans', that is, CC articles 1813–1822 governing loans of money or other fungibles, 'are observed, insofar as applicable'. Yet, in departure from all other jurisdictions under discussion, Italy specifically regulates the bank deposit, albeit as a specie of an irregular deposit, as a banking contract.<sup>97</sup> Thus, under CC article 1834, '[b]y the deposit (1782) in a bank of a sum of money the bank acquires ownership of it and is bound to repay it in the same kind of money at the expiration of the agreed term or on demand of the depositor, observing the period of advance notice established by the parties or by usage.' CC article 1834 further states that '[i]n the absence of contrary agreement, all deposits and withdrawals shall be made at the same office of the bank at which the relationship was established.'<sup>98</sup>

Modern financial practices have put to test the elasticity of the 'bank deposit' as the typical debt owed by the paymaster to the payer in several ways:

1. A 'pre-paid card' such as a gift, payroll or remittance card may access, within the limits set for the card, funds deposited in a pooled account belonging to the scheme operator (such as the employer in the case of a payroll card) rather than an account of the payer;<sup>99</sup>
2. A 'smart card' or another stored-value product (SVP) belonging to the payer may be used to load value on the SVP itself so that in each cash payment value will be subtracted from the SVP and not a traditional bank account;<sup>100</sup>

<sup>96</sup> The translated provision speaks of the depositary as authorized to make use of the deposit, and may further be read to confer on the depositary ownership in the deposit. The better reading of the provision is, however, as in the bracketed text. Stated otherwise, the depositary may use, and acquires ownership in, the money or things deposited and not the deposit.

<sup>97</sup> Other banking contracts dealt with by the Italian civil code concern safe deposit boxes (CC arts 1839–1841), opening bank credit (CC arts 1842–1845) bank advances (CC arts 1846–1851), banking transactions for current accounts (CC arts 1852–1857), and bank discount (CC arts 1858–1860).

<sup>98</sup> The following provisions dealing with bank deposits, namely, CC arts 1835–1838, cover pass-books, including those issued to the bearer or to a minor, and deposits of securities.

<sup>99</sup> For these cards see eg Geva, 'Recent Developments', above n 12 at 699–705.

<sup>100</sup> See in general, eg B Geva and M Kianieff, 'Reimagining E-Money: Its Conceptual Unity with Other Retail Payment Systems' (2005), 3 *Current Developments in Monetary and Financial Law* 669.

3. Payment may be made by the payer to a payment institution<sup>101</sup> with whom the payer does not have a bank account, which will then transfer the funds to a payee elsewhere; and
4. Payment from a payer to a payee may be carried out through a payment aggregator<sup>102</sup> or consolidator<sup>103</sup> receiving and/or holding funds to be used in usually small-value payments and channeling them from consumers' accounts with banks to those of retailers.

In all such cases the 'reservoir' for making payment is the same as the 'bank deposit'. In the first case the account holder fulfills a trustee function for the payer. The second case is that of a 'decentralized' account whose activities are recorded on the SVP.<sup>104</sup> The 'electronic money' loaded on the SVP is 'electronically . . . stored monetary value . . . represented by a claim on the issuer which is issued on receipt of funds for the purpose of making payment transactions.'<sup>105</sup> E-money is issued 'at par value on the receipt of funds' and is redeemable 'upon request.'<sup>106</sup> As such, even when it is issued by a non-bank 'electronic money institution'<sup>107</sup> it is no different from any other 'monetary value' on deposit with a bank. Indeed, the drafters of the EU E-money Directive stated that '[t]he issuance of electronic money does not constitute a deposit taking activity pursuant to [the Banking Directive]'.<sup>108</sup> However, in my view this is not to say that the issuance of e-money is not 'deposit taking'; rather, it is not part of the activity singled out to a credit institution or bank. The latter is 'an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account.'<sup>109</sup>

The third case is a restricted use deposit for a single purpose and yet still a deposit.<sup>110</sup> Finally, the fourth case involves further intermediaries but does not

<sup>101</sup> Defined in art 4(4) of the PSD, above n 14, to mean 'a legal person that has been granted authorisation in accordance with Article 10 to provide and execute payment services throughout the Community'. See text and n 27 above.

<sup>102</sup> Payment aggregators typically hold consumer credit card information to allow for faster purchases, or hold money in an account to allow for future purchases. They make payments from consumers to merchants thereby allowing the latter to accept credit card and bank transfers without having to setup a merchant account with a bank or card association. Visit eg [www.fraudpractice.com/alt-paymentaggre.html](http://www.fraudpractice.com/alt-paymentaggre.html). Payment aggregators present an 'interesting extension to the mediated model' involving intermediary parties as brokers in payment transactions. See M Van Bossuyt and L Van Hove, 'Mobile Payment Models and Their Implications for NextGen PSPs' (2007), 9:5 info: *Journal of Policy, Regulation and Strategy* 31 at 40.

<sup>103</sup> See eg N Chande, 'A Survey and Risk Analysis of Selected Non-bank Retail Payments Systems' (2008) *Bank of Canada Discussion Paper* 2008-17, available online at [www.bankofcanada.ca/en/res/dp/2008/dp08-17.html](http://www.bankofcanada.ca/en/res/dp/2008/dp08-17.html).

<sup>104</sup> See Geva and Kianief, above n 100 at 685.

<sup>105</sup> E-money Directive, above n 19, art 2(2).

<sup>106</sup> *Ibid* art 11.

<sup>107</sup> Defined in the E-money Directive, *ibid* art 2(1), as 'a legal person that has been granted authorisation . . . to issue electronic money'.

<sup>108</sup> *Ibid* Preamble para 13.

<sup>109</sup> Art 4(1) of the Banking Directive, above n 19.

<sup>110</sup> R Bollen, 'What is a Deposit (and Why Does it Matter)?' (2006), 13(2) *E-Law – Murdoch University Electronic Journal of Law* 202.

change the fundamental nature of the movement of funds from one deposit account to another.

Funds held by ‘payment institutions’ and ‘electronic money institutions’ are either to be covered by insurance or segregated and insulated from claims by the institution’s own creditors.<sup>111</sup> Segregated funds may be ‘invested in secure, liquid low-risk assets.’<sup>112</sup> However, unlike money deposited with a bank, they cannot be lent by the institution so as to further increase the money supply.<sup>113</sup> At the same time, from the perspective of a party to a payment transaction, these funds are held on ‘deposit’ with the institution just as they would be held with a bank.

#### 4. THE PAYMENT ORDER AND ITS EXECUTION UNDER MODERN LAW

Executing, receiving and collecting payments on the customer’s behalf are important bank functions under the banking contract. Payment could be made from one account into another either at the same bank or at two different banks. In the latter case, the two banks may settle either bilaterally over a correspondent account each holds with the other, or multilaterally, over the books of a common correspondent, possibly the central bank. Alternatively, the two banks may be linked through more banks, with each link being either a bilateral or multilateral settlement.<sup>114</sup>

As pointed out in chapter one, section 4 above, an account (or funds) transfer is initiated by a payment order communicated by a customer to a bank and is carried out by means of a debit to the payer’s account and a credit to that of the payee. Depending on the manner in which payment instructions are communicated to the payer’s bank, which affects the sequence of the banking operations in debiting the payer’s account or crediting the payee’s account, account transfers are divided into debit and credit transfers. As a rule, the communication flow and the movement of funds are in opposite directions in a debit transfer but in the same direction in a credit transfer.

Thus, in a debit transfer, the payer’s instructions are communicated to the payer’s bank by the payee through the payee’s bank. Such instructions are to be initiated by the payee pursuant to the payer’s authority, as for example, in connection with recurring mortgage or insurance premium payments. When the instructions are first communicated by the payee to the payee’s bank, the payee’s account may be credited. When the instructions ultimately reach the payer’s bank, the payer’s account is debited; that is, in a debit transfer, the credit to the payee’s account

<sup>111</sup> PSD, above n 14, art 9. For electronic money institutions it is incorporated by reference in E-money Directive, above n 19, art 7.

<sup>112</sup> PSD, *ibid* art 9(1)(a). For electronic money institutions, it is incorporated by reference in E-money Directive, *ibid* art 7.

<sup>113</sup> For the expansion of the money supply by commercial bank lending, see ch 10, section 3.4 above.

<sup>114</sup> For a brief description of the salient elements of the multilateral aspect of this architecture see above, ch 1, text around nn 55–61. For the evolution of the architecture, see above, ch 10, sections 2.3 and 3.3.

precedes the debit to the payer's account. The credit to the payee's account, however, is initially provisional and is subject to reversal if the payer's bank dishonours the payer's instructions, for example, for lack of funds, and communicates its rejection to the payee's bank. Credit to the payee's account is final only when the payer's bank becomes accountable for the item, usually in connection with the irreversibility of the debit posted to the payer's account. In a debit transfer, funds credited to the payee's account are collected or 'pulled' from the payer's account.

In contrast, in a credit transfer, such as a direct deposit of payroll, benefit, interest, pension or dividend, the payer's instructions are communicated to the payer's bank directly by him, without the mediation of a credit to the payee's account at the payee's bank. When the instructions are communicated, the payer's account is debited. As such, in a credit transfer, unlike in a debit transfer, the first impact of the payer's instructions on the banking system is a debit to the payer's account with the payer's bank. Having received the payer's instructions and debited the payer's account, the payer's bank forwards the instructions to the payee's bank, which then proceeds to credit the payee's account. Thus, in a credit transfer, the debit to the payer's account precedes the credit to the payee's account, and the payment is not subject to reversal, for example for lack of funds in the payer's account.<sup>114.1</sup> In a credit transfer, funds debited to the payer's account are 'pushed' to that of the payee. In principle, a credit transfer is completed when the payee becomes owed by his bank. In contrast, a debit transfer is completed when the payer's bank becomes irreversibly accountable for the item.<sup>115</sup>

Customer and interbank payment orders may be written, electronic, or even oral. In both debit and credit transfers, whenever the payer's and payee's accounts are at the same bank, no interbank communication is required. Nonetheless, the sequence of banking operations, as set out above, is unaffected.

It is tempting to think of the payment order as transferring a deposit in whole or in part from one person to another. Indeed, at least one regulatory statute speaks of institutions holding 'deposits transferable by order to a third party' as participants in a national payment system.<sup>116</sup> However, as explained below, the prevailing legal perspective is that the payment order does not transfer a deposit or any part thereof. Rather, the impact of the process initiated by the payment order is to extinguish the payer/order-giver's claim to a deposit balance and to create a new claim to a deposit balance in the third party/payee's hands. Subject to bank charges and fees that may be incurred, the reduction in the payer's balance is in the same amount as that of the increase in the payee's balance; that is, both deposit-balance claims, the one the payer had before the process, and the other the payee has at its conclusion, are in the same amount. It is in this

<sup>114.1</sup> In the case of lack of funds in the payer's account, the transfer will be 'aborted' and not be carried out.

<sup>115</sup> For a detailed analysis, see B Geva, 'Payment Finality and Discharge in Funds Transfers' (2008), 83 *Chicago-Kent Law Review* 633 (hereafter: Geva, 'Payment Finality').

<sup>116</sup> *Canadian Payments Act*, R.S.C. 1985, c. C-21, ss 2(1) (definitions of 'loan company' and 'trust company'), 4(2)(a) and (c), (entitled members).

sense that the impact of the payment order is said to 'transfer' funds from one deposit balance to another.

In examining the law governing payment orders in selected major jurisdictions, attention will first be given to orders to pay contained in bills of exchange (drafts) and cheques. No distinction is to be made between these two instruments; they are both negotiable instruments, usually<sup>117</sup> governed in each jurisdiction by the same or similar legislation, with the cheque,<sup>118</sup> rightly or wrongly, considered a specie of the bill,<sup>119</sup> and in fact specifically provided as such in England<sup>120</sup> and the United States.<sup>121</sup>

Under modern negotiable instruments legislation,<sup>122</sup> the bill of exchange (or draft) is an unconditional written signed order, addressed by one person to another, requiring the person to whom it is addressed to pay a sum certain in money. It may be payable to the order of a designated payee or (though not everywhere) to the bearer, on demand or at a fixed or determinable future time.<sup>123</sup> The cheque is a bill payable on demand drawn on a bank.<sup>124</sup> The bill (including the cheque) may be transferred from one person to another by 'negotiation', consisting of either a mere delivery in the case of a bill payable to the bearer, or of delivery plus the transferor's signed 'endorsement'<sup>125</sup> in the case of a bill payable to the order.<sup>126</sup>

<sup>117</sup> Though, there are exceptions, as eg the Australian *Cheques Act 1986* (Cth.) (as amended).

<sup>118</sup> Albeit, there may be an additional statute governing specific matters relating to cheques, as eg, the English *Cheques Act, 1957* (UK), 5 & 6 Eliz. II, c. 36.

<sup>119</sup> See ch 11, section 5 above.

<sup>120</sup> *Bills of Exchange Act, 1882* (UK), 45 & 46 Vict., c. 61 (hereafter: BEA), s 73 defining 'cheque' as 'a bill of exchange drawn on a banker payable on demand'.

<sup>121</sup> Article 3 of the American *Uniform Commercial Code* (1990, as amended, 2002) (hereafter: U.C.C. Article 3); U.C.C. §3-104(f), defining 'check' as essentially 'a draft . . . payable on demand and drawn on a bank'. Under U.C.C. Article 3, 'draft' is used to denote a bill of exchange. See U.C.C. §3-104 (a) and (e), and Official Comment 4.

<sup>122</sup> Particularly, the English BEA, above n 120, on which legislation throughout the world is modelled in common law jurisdictions and others that have been under British influence; *Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes*, 7 June 1930, 143 L.N.T.S. 257, Annex I (hereafter: Geneva Bills Convention), on which legislation throughout the world is modelled in civil law countries including those in Continental Europe; U.C.C. Article 3 above n 121; and 'United Nations Convention on International Bills of Exchange and International Promissory Notes' (UN Doc. A/RES/43/165) in *Yearbook of the United Nations* 1988, vol 42 (New York: UN, 1988) at 834 (hereafter: UNCITRAL Bills Convention).

<sup>123</sup> Relevant provisions, in each case in conjunction with immediately ensuing ones, in each of the sources cited in the immediately preceding note, are BEA s 3(1); Geneva Bills Convention art 1; U.C.C. §3-104; and UNCITRAL Bills Convention art 3(1) (the latter two do not cover a bill stated to be payable to bearer).

<sup>124</sup> For cites see nn 120–21 above.

<sup>125</sup> According to JM Holden, *The History of Negotiable Instruments in English Law* (London: University of London: The Athlone Press, 1955, reprint 1993, WM W Gaunt & Sons) at 44, fn 6, '[t]he spelling 'endorse' is more common than 'indorse' in commercial practice'. At the same time, he goes on to say, '[t]he Bills of Exchange Act, 1882, adopted the spelling "indorse". *Ibid.* I should add that, on that point, U.C.C. Article 3, above n 121, follows suit and uses 'indorse'. In contrast, the Canadian spelling, reflected in the *Bills of Exchange Act*, R.S.C. 1985, c. B-4, and adopted by me in this text, is 'endorse'.

<sup>126</sup> BEA s 31; Geneva Bills Convention art 11; U.C.C. §3-201; UNCITRAL Bills Convention art 13. The term 'negotiation' appears only in the BEA and in U.C.C. Article 3. An endorsement which

The general rule is that a signature is a necessary requirement for liability on a bill of exchange.<sup>127</sup> One exception is under French law, which allows the holder to recover from the drawee, on the basis of *la provision*, that is, what the drawee owes the drawer, even without an acceptance.<sup>128</sup> A similar exception applies in Scotland, where a bill is stated to operate as an assignment of funds 'from the time when the bill is presented to the drawee.'<sup>129</sup> The broad principle, overwhelmingly applicable elsewhere,<sup>130</sup> is however that '[a] check or other draft does not of itself operate as an assignment of funds in the hands of the drawee available for its payment';<sup>131</sup> a drawee incurs liability on a bill only by signing as an acceptor.<sup>132</sup> It is against this background that, as long as it has not been acted on by the drawee, in principle, the cheque is revocable.<sup>133</sup>

Even other than for bills and cheques, and in the absence of a specific statutory provision on the point, the assignment of debt is overwhelmingly rejected as the explanation for the transfer of funds. Thus, a credit transfer is explained as a process under which the debt owed to the payer by his bank is ultimately replaced by a new debt owed to the payee by his bank. To that end, the characterization of the process as a 'transfer' is certainly a misnomer,<sup>134</sup> as in fact nothing tangible or intangible is transferred. Rather, one debt, owed by a bank to the payer, extinguishes (or decreases), and allows for another debt, that of a

does not designate the transferee is an endorsement in blank, which effectively 'converts' the bill into one payable to the bearer. This is true even where instruments originally issued payable to the bearer are not recognized (see n 123 above). For the 'conversion' by blank endorsement of the bill payable to order see eg BEA s 34(1); Geneva Bills Convention arts 12–13; U.C.C. §3-205; UNCITRAL Bills Convention arts 13–16. For the cite of each of the four sources, see nn 120–22 above.

<sup>127</sup> BEA s 23; Geneva Bills Convention arts 7–8; U.C.C. §3-401; UNCITRAL Bills Convention art 33. For the cites of each of the four sources, see *ibid*.

<sup>128</sup> For *la provision* in French law, see eg C Gavalda and J Stoufflet, *Instruments de Paiement et de Crédit*, 7th edn rédigée by J Stoufflet (Paris: Litec, imprint, 2009) at 105–14; and for a summary, P Ellinger, 'Negotiable Instruments' in JS Ziegel (chief ed), *Commercial Transactions and Institutions*, vol IX of U Drobnig and K Zweigert (responsible eds), *International Encyclopedia of Comparative Law* (Tübingen: JCB Mohr, 2000) ch 4 at 110–13. See also G Ripert and R Roblot, *Traité de Droit Commercial*, 13th edn (Paris: Librairie Générale de Droit et de Jurisprudence, 1992) at 181–86. For a more extensive analysis, see P Lescot and R Roblot, *Les Effets de Commerce* (Paris: Rousseau, 1953) vol I at 389–465.

<sup>129</sup> BEA s 53(2). The subsection is stated (by language inserted by *Law Reform (Miscellaneous Provisions) (Scotland) Act 1985* (UK), 1985, c. 73, SIF 30, s 11(a)) to be subject to BEA s 75A, providing for the customer's right to countermand payment on a cheque; this is unclear since the right to countermand does not survive the presentment for payment.

<sup>130</sup> Though not necessarily in French-based systems, for which see in general Ellinger, above n 128 at 70–72.

<sup>131</sup> U.C.C. §3-408. See also BEA s 53(1) (almost verbatim).

<sup>132</sup> *Ibid*. See also UNCITRAL Bills Convention arts 37, 40. Cf Geneva Bills Convention arts 21, 25, and 28. For the cites of each of the four sources, see nn 120–22 above.

<sup>133</sup> See eg BEA s 75 ('The duty and authority of a banker to pay a cheque drawn on him by his customer are determined by – (1) Countermand of payment; (2) Notice of the customer's death'). See also U.C.C. §4-403; and cf art 32 of the *Convention Providing a Uniform Law for Cheques*, 19 March 1931, 143 L.N.T.S. 355, Annex I.

<sup>134</sup> Notwithstanding dicta in *Delbrueck v Manufacturers Hanover Trust Co* 609 F.2d 1047 (2nd Cir. 1979) at 1051, under which a 'funds transfer' was treated as the assignment of a debt.

bank to the payee, to arise (or increase) and substitute it substantially<sup>135</sup> for the same amount.<sup>136</sup> Stated otherwise, the payment order does not initiate an assignment of funds held by the payer's bank.<sup>137</sup> This is true for a debit transfer as well.<sup>138</sup>

In the *United States*, under Article 4A of the *Uniform Commercial Code*, in a credit transfer, each payment order is a request by the sender to the receiving bank which can be accepted or rejected.<sup>139</sup> Until acceptance, a payment order may be revoked.<sup>140</sup> A payment order does not create agency or mandate. Nor is it tantamount to the assignment of funds.<sup>141</sup> Acceptance by a receiving bank other than the beneficiary's bank is by the execution of the payment order, that is, by the issue of a corresponding payment order, intended to carry out the one received by the bank (*Uniform Commercial Code* §§4A-209 and -301). The executing bank must issue a payment order that conforms to that received by it with respect to the amount, the ultimate destination of the funds, and the identity of any specifically designated intermediary bank (*Uniform Commercial Code* §4A-302). Upon the execution of a payment order, its sender becomes obligated to pay the executing receiving bank the amount of the order (*Uniform Commercial Code* §4A-402(c)). The executing bank's duties to the sender are to be carried out with reasonable care and skill (*Uniform Commercial Code* §4A-302.). A bank is neither vicariously liable for the deficient execution by another bank nor liable for its own deficient execution to a participant with whom it is not in privity (*Uniform Commercial Code* §4A-212). Under a 'money-back guarantee' and regardless of fault, a receiving bank is liable to its own sender for the amount of the order;<sup>142</sup> it is also liable to its sender for expenses and incidental losses, but usually not for consequential losses.<sup>143</sup> A funds transfer is completed by the acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary (payee) of the originator's (payer's) payment order (*Uniform Commercial Code* §4A-104(a)). Acceptance by the beneficiary's bank is either by receiving payment from the sender of the payment order or by

<sup>135</sup> Possibly subject to charges levied by banks.

<sup>136</sup> *Libyan Arab Foreign Bank*, above n 89 at 269 (All E.R.), 273 (Lloyd's Rep.) (specifically disapproving the dicta in *Delbrueck v Manufacturers Hanover Trust Co*, above n 134 at 1051, though without specifically identifying the case).

<sup>137</sup> *R v Preddy* [1996] A.C. 815 at 834 (H.L.).

<sup>138</sup> Other than in Scotland where, like a cheque, each 'instruction to pay' issued to the payer's bank (and yet not the mere authority given by the payer to comply with such instructions when duly presented by the payee) has (subject to the availability of funds in the payer's account 'at the critical date') an 'assignative effect'. See *Mercedes-Benz Finance Ltd v Clydesdale Bank plc* 1996 SCLR 1005 at 1110-11 (Court of Session, Outer House) (hereafter: *Mercedes-Benz Finance*).

<sup>139</sup> U.C.C. §4A-209, Official Comment 1.

<sup>140</sup> U.C.C. §4A-211. Under §4A-211(g), it 'is not revoked by the death or legal incapacity of the sender unless the receiving bank knows of the death or of an adjudication of incapacity'.

<sup>141</sup> See in general U.C.C. §4A-212 (and Official Comment) as well as §4A-209, Official Comment 1.

<sup>142</sup> U.C.C. §4A-402(e) and Official Comment 2.

<sup>143</sup> U.C.C. §§4A-212, -303, and -305. Scope of liability may however be expanded 'by express agreement' (§4A-212), or in order to be liable for consequential losses, by means of 'an express written agreement of the receiving bank' (§4A-305(d)).



paying or advising the beneficiary of the order (*Uniform Commercial Code* §4A-209(b)).

In civil law it is likewise uncommon to analyse the funds transfer as a cession, that is, the assignment of funds.<sup>144</sup> For credit transfers this is true even in France, notwithstanding the fact that, as indicated, under French law the cheque operates to transfer to the payee-holder funds available in the drawer's account.<sup>145</sup> As well, in civil law jurisdictions, inasmuch as the delegation is premised on the assumption of an obligation by the paymaster towards the payee as a party to an agreement with him, rather than the payment made by the payer to the payee by means of debits and credits to bank accounts, also the delegation is disfavoured.<sup>146</sup> Delegation is, however, favoured as an explanation for the paymaster's liability to the payee, where such liability exists, as, for example, in card payments.<sup>147</sup>

*Germany* and *Switzerland* are unique in having provisions in their civil codes<sup>148</sup> addressing payment orders. The Swiss Code of Obligations (CO) contains provisions applying to 'orders' (CO articles 466–471), initiating both credit and debit transfers. In contrast, the German Civil Code (BGB) provisions covering 'orders' (BGB §§783–792) are limited to written instructions<sup>148.1</sup> initiating debit transfers.<sup>149</sup>

Under both Swiss CO article 466 and German BGB §783, an order constitutes a double authority from the order giver (the 'drawer' in Germany). First, it is directed to the recipient of the order (the 'drawee' in Germany) to pay<sup>150</sup> the payee for the account of the order giver/drawer. Second, the order is directed to the payee, authorizing him to collect in his own name from the recipient/drawee. In Germany, the order must be contained in 'an instrument' and be delivered by

<sup>144</sup> Together with contract for the benefit of a third person and delegation, assignment (that is, cession) of debts has been 'moved into the background' as the legal theory underlying the credit transfer in Italy. See C Costa, 'The Actual Significance of and the Law Relating to Foreign Funds Transfers in Italy' in W Hadding and UH Schneider (eds), *Legal Issues in International Credit Transfers* (Berlin: Duncker & Humblot, 1993) 267 at 272. German authors in Hadding and Schneider, *ibid*, do not discuss the assignment theory.

<sup>145</sup> A point made by Gavalda and Stoufflet, above n 128 at 424.

<sup>146</sup> Particularly see M Vasseur, 'Law and Practice of Foreign Funds Transfers in France' in Hadding and Schneider, above n 144 at 237, 242–45.

<sup>147</sup> For a discussion of delegation in this context, see eg X Thunis, *Responsabilité du Banquier et Automatisation des Paiements* (Namur: Presses Universitaires, 1996) at 103–09. The paymaster's obligation is discussed in the context of delegation below, section 6.

<sup>148</sup> Civil codes discussed in this chapter are cited above in n 93.

<sup>148.1</sup> It is disputed whether an electronic declaration with a qualified electronic signature also suffices; as well, an oral order is not invalid and BGB §§783–792 may as far as practical apply by analogy. See M Habersack, §783 nos. 16 and 19, in FJ Säcker and R Rixecker (eds), *Münchener Kommentar zum Bürgerlichen Gesetzbuch: BGB Band 5: Schuldrecht • Besonderer Teil III §§705–853 Partnerschaftsgesellschaftsgesetz, Produkthaftungsgesetz* 5th edn (München: Verlag CH Beck, 2009) [in German]. I have relied on an unofficial translation.

<sup>149</sup> Terminology in the original languages is to be noted. The operation triggered by an 'order' dealt with in those provisions is *anweisung* in German and *assignation* in French.

<sup>150</sup> Under the provisions, the order directed to the recipient/ drawee may be to remit to the payee money, securities or other fungibles. We are concerned here only with the remittance (namely, payment) of money.

the drawer to the payee. Hence, the 'order' initiates a debit transfer, that at least commences as paper-based. No such limitations exist in Switzerland where, consequently, the payment order may initiate both electronic and paper-based, as well as both credit and debit, transfers.

In both Switzerland (CO article 467(1)) and Germany (BGB §788), where the order is intended to discharge a debt of the order giver/drawer to the payee, the debt is discharged only upon payment by the recipient/drawee (paymaster in our paradigm) to the payee. Stated otherwise, the acceptance by the recipient/drawee/paymaster does not serve as an absolute discharge to the order giver/drawer towards the payee. In Switzerland, under CO article 467(2), 'the payee who has agreed to the order can only renew his claim against the order giver if, having demanded payment from the recipient of the order, he was unable to obtain it at the expiration of the term stated in the order.' The issue of the payment order thus suspends the obligation of the order giver/payer and operates to conditionally discharge it. Under CO article 467(3), to avoid liability for damages, in connection with a debit transfer, the payee who receives the order directly from the order giver must, if he does not intend to follow up his claim on it, notify the order giver of his refusal promptly.

In both Switzerland (CO article 468(1)) and Germany (BGB §784(1)), acceptance of the order by the recipient/drawee (that is, the paymaster) binds him towards the payee, who can enforce the acceptance free from defences available to the recipient/drawee against the order giver/drawer. In Switzerland (CO article 468(1)), acceptance is to be notified by the recipient to the payee 'without reserve.' In Germany, under BGB §784(2), the acceptance is made 'by a written notation on the order.' Where that notation has been made before the delivery of the order to the payee, the acceptance becomes effective upon delivery. Stated otherwise, the obligation undertaken by the recipient/drawee/paymaster is autonomous, at least by reference to the forfeiture of defences he could have raised against the order giver/drawer.

The drawee's position in Germany is further governed by three rules. First, under BGB §786, the payee's claim against the drawee arising from the acceptance 'is barred by prescription in three years.' Second, under BGB §785, the drawee is bound to pay 'only on presentation of the order.' Third, under BGB §789, upon the drawee's refusal to accept or pay, 'the payee shall give notice to the drawer without delay.' The latter provision has a counterpart in Switzerland, that is, CO article 469 which states:

If the recipient of the order refuses the payment demanded of him by the payee or if he declares in advance that he will not pay, [the payee]<sup>151</sup> must immediately advise the order giver of such refusal, in order to avoid paying liquidated damages.

<sup>151</sup> While the wording (in the French original as well as in the English translation) is not unambiguous, it is undisputed in Switzerland that the duty to give notice rests, as in Germany, on the payee (and not the recipient).

Presumably, damages may be caused to the order giver due to his failure to have a timely payment made. Alternatively, having been indebted by the recipient of the order and expecting to give him discharge on the basis of the recipient's payment to the payee, the order giver may have lost an effective recourse against the recipient of the order due to the payee's delay in advising him of the order recipient's refusal.

In Switzerland, under CO article 468(2), '[t]o the extent the recipient of the order is indebted to the order giver', he is liable, vis-a-vis the latter, to pay the payee, 'provided his position is not prejudiced thereby.' However, '[e]ven in such a case, he is not obligated to notify his acceptance prior to payment, unless so agreed with the order giver' (CO article 468(3)). Conversely, in Germany, under BGB §787(2), '[t]he drawee is not bound as against the drawer to accept the order or to make payment . . . to the payee merely because the drawee is a debtor of the drawer.' However, upon payment to the payee, the drawee is discharged from the debt he owes to the drawer (BGB §787(1)).

In both Switzerland (CO article 470(2)) and Germany (BGB §790), vis-a-vis the recipient/drawee, the order is revocable by the order giver/drawer until acceptance or payment. In Switzerland, under CO article 470(1), the revocation against a payee is wrongful, where the order 'has been made to extinguish a debt owed [by the order giver] to the payee or otherwise has been made for the benefit of the latter.' In Switzerland, under CO article 470(3), '[t]he bankruptcy of the order giver entails the revocation of an order which has not yet been accepted.' Conversely, in Germany, under BGB §791, an order 'is not extinguished by the death of one of the parties or by one of the parties becoming incompetent to enter into legal transactions.'

Finally, in Germany, under BGB §792, the payee may transfer the order by agreement in writing and the physical delivery of the instrument, unless transferability has been excluded by the drawer. To be effective against the drawee, the exclusion must either be noted in the instrument or communicated to the drawee before acceptance for payment. Upon acceptance in favour of the transferee, the drawee may not raise defences available to him against the payee. 'For the rest, the provisions applicable to assignment of a claim apply *mutatis mutandis* to the transfer of the order.' In Switzerland, CO article 471(1) recognizes the effectiveness of '[w]ritten orders to pay the respective bearer of the instrument.'

To a large extent, the Swiss and the German payment order can be traced to the Medieval non-bank 'assignation', generating a defence-free transfer with recourse of a debt on the basis of the tripartite agreement of the payer, payee and paymaster.<sup>152</sup> More specifically, the operation is premised on a sequential series of three bilateral agreements, altogether involving all three parties: payer-payee, payer-paymaster, and paymaster-payee. In effect, the Swiss and the

<sup>152</sup> See ch 8, text around nn 40–43, above. For *assignatio* in Roman law, see ch 5, text and nn 261–64.

German payment order does not initiate a cession.<sup>153</sup> Rather, in a conceptual framework derived from Roman law,<sup>154</sup> the Swiss and the German payment order initiates the execution of an imperfect, albeit novatory, absolute delegation order.<sup>155</sup>

## 5. THE PAYMENT ORDER AS A MANDATE

A common denominator among all major legal systems is the treatment of the payment order as a mandate. Thus, in both common law<sup>156</sup> and civil law<sup>157</sup> jurisdictions, the cheque is a mandate, given by the drawer as a mandator to the drawee bank as mandatary.<sup>158</sup> Also, the collection of cheques is a mandate under which the collecting bank acts as a mandatary<sup>159</sup> or agent<sup>160</sup> for the depositor.<sup>161</sup> By extension, this is the case also for any debit transfer.<sup>162</sup> The Italian civil code goes as far as to explicitly provide that in executing a customer's instructions 'the bank is answerable according to the rules concerning mandate' (CC article 1856(1)).

Furthermore, under the civil law, the entire relationship between a customer and a drawee bank, under which the latter is to carry out the former's payment instructions, may be regarded as a mandate.<sup>163</sup> Indeed, in various countries, funds transfers may be partly governed by other provisions of the civil codes, or

<sup>153</sup> Cf J Duponchel, *De la Cession d'Actions en Droit Romain. Du Titre à Ordre et des Conséquences qui s'y Rattachent en Droit Français* (Versailles: Imprimerie de Beau Jeune, 1870) at 10, who compares between *assignatio* and *cessio*, but not between *assignatio* and *delegatio*.

<sup>154</sup> See ch 5, sections 5 and 6 above. Note that, in the original Roman law classification, the novatory absolute delegation was associated with the perfect rather than imperfect delegation. *Ibid*, particularly section 6.2.

<sup>155</sup> For the assignation as derived from the delegation, see in general P Sorbier, *L'Ancien Contrat d'Assignation de Créance; ou Délégation Commerciale à Titre de Nantissement: Son Emploi dans les Banques pour Garantir un Compte Courant* (Paris: Imprimerie de France, 1937).

<sup>156</sup> See eg *London Joint Stock Bank v Macmillan* [1918] A.C. 777 at 789 (H.L.), and in general, H Luntz, 'Cheques as Mandates and as Bills' (1997), 12 *Business and Finance Law Review* 189.

<sup>157</sup> See eg Gavalda and Stoufflet, above n 128 at 237.

<sup>158</sup> For characterizing the banker and customer relationship in respect of the payment of the customer's cheques as that of an agent and principal, see eg *Selangor United Rubber Estates v Cradock* (No 3) [1968] 1 W.L.R. 1555 at 1594 (Ch. D.). For the relationship between agency and mandate see n 161 below.

<sup>159</sup> See eg Gavalda and Stoufflet, above n 128 at 257.

<sup>160</sup> For the position of the collecting bank as an agent for the depositor under the common law, see eg *Barclays Bank v Bank of England* [1985] 1 All E.R. 385 (and cases cited there). See also *Riedell v Commercial Bank of Australia* [1931] V.L.R. 382 (S.C.). For the same position in the US, see U.C.C. §4-201(a) and §4-103 Official Comment 3.

<sup>161</sup> For the distinction and commonality between agency and mandate, being related but not identical, see RW Lee, *The Elements of Roman Law with a Translation of the Institutes of Justinian*, 4th edn (London: Sweet & Maxwell, 1956) at 336. Briefly stated, agency is created by a mandate, in which case the agency focuses on the relationship between the principal and a third party, and the mandate is concerning the relationship between the mandator-principal and the mandatary-agent.

<sup>162</sup> Cf *Mercedes-Benz Finance*, above n 138 (albeit in connection with Scotland).

<sup>163</sup> See eg in Switzerland, D Guggenheim, above n 95 at 256.

even, as in the European Union, by specific legislation.<sup>164</sup> An extensive discussion of existing laws in major jurisdictions is beyond the scope of this study.<sup>165</sup> However, with one major exception, that of Article 4A of the American *Uniform Commercial Code*, in relation to a payment order initiating a non-consumer credit transfer,<sup>166</sup> such legislation has not repudiated the centrality of the mandate as the cornerstone for the analysis of the legal relationship underlying the payment order. It is because of its roots in pre-Medieval Roman law<sup>167</sup> that modern mandate law, as applicable to the order to pay money, merits discussion.

According to Pothier,<sup>168</sup> the underlying contract between a drawer and drawee of a bill of exchange<sup>169</sup> is that of a mandate. Such a contract is implicitly made by a banker upon receiving funds from the drawer for paying the latter's bills. A distinction is drawn between the specific mandate relating to each bill of exchange, and the general mandate governing the overall agreement under which the banker is to pay the drawer's bills drawn on that banker.

However, 'mandate' does not necessarily mean the same thing in the common law and civil codes.<sup>170</sup> As discussed in chapter five, section 3 above, under Roman law, the mandate is broadly defined as 'a contract whereby one person (mandator) gives another (mandatary) a commission to do something for him'.<sup>171</sup> In principle, this definition was adopted by the various civil codes.<sup>172</sup> Conversely, in the common law, the scope of the mandate is substantially narrower; it merely denotes '[a] direction or request'<sup>173</sup> or an instruction.<sup>174</sup> Accordingly, in English law, the mandate did not attract such vast scholarship, doctrine, and jurisprudence as in the civil law.

Moreover, reciprocal duties of the mandator and the mandatary have been treated differently by the common law and in civil codes. English law fastened on both parties reciprocal duties of care.<sup>175</sup> This is in departure from classical

<sup>164</sup> *Implementing the PSD*, above n 12.

<sup>165</sup> See eg Geva, *Bank Collections*, above n 1 at 125–339 (the performance of the mandate in making and collecting payments under laws of various jurisdictions).

<sup>166</sup> See discussion around nn 218–24 below, where it is explained that even in U.C.C. Article 4A this is more an apparent, rather than real, exception.

<sup>167</sup> For the delegation order as a 'mandate' under Roman law, see ch 5, section 3 above.

<sup>168</sup> RJ Pothier, *Traité du Contrat de Change*, new edn by JB Hutteau (Paris: Letellier, Garnery, 1809) at 55–68.

<sup>169</sup> For cheques as bills of exchange see text and nn 118–21 above.

<sup>170</sup> Civil codes discussed in this chapter are cited above in n 93.

<sup>171</sup> See eg Lee, above n 161 at 334.

<sup>172</sup> See eg Swiss CO art 394(1); French CC art 1984 (where the mandatary's action must be in the mandator's name); Italian CC art 1703; Japanese CC art 643 (in conjunction with art 656); Quebec CC art 2130; and BGB §662 (in conjunction with §675) in Germany. In Italy and Quebec the mandate is limited to the accomplishment of a legal transaction or the performance of a juridical act. Arguably, the payment of the drawer's debt falls into this category.

<sup>173</sup> D Greenberg, *Jowitt's Dictionary of English Law*, 3rd edn (London: Sweet & Maxwell; Thomson Reuters, 2010) at 1409 (hereafter: *Jowitt's Dictionary of English Law*).

<sup>174</sup> See eg *National Westminster Bank v Barclays Bank International* [1975] Q.B. 654 at 666; and *Barclays Bank v W J Simms Son & Cooke (Southern)* [1980] Q.B. 677 at 699.

<sup>175</sup> See text at nn 192–210 below.

Roman law<sup>176</sup> under which the mandatary was liable only for *dolus*,<sup>177</sup> namely, an intentional wrongful act,<sup>178</sup> or breach of good faith.<sup>179</sup> Over the years, the mandatary's liability had been expanded;<sup>180</sup> in modern civil codes, the mandatary owes the mandator a duty of care.<sup>181</sup> As for the mandator, other than in Switzerland where he is exempt from liability not caused by his fault,<sup>182</sup> the mandator is liable to the mandatary beyond negligence,<sup>183</sup> namely, for all losses and damages incurred by the mandatary in connection with the execution of the mandate.<sup>184</sup>

I will now outline the treatment of the mandator-mandatary relationship in civil codes of selected jurisdictions. True, in each such code the mandate does not necessarily provide a complete scheme governing the payment order. However, it does at least establish the foundation of the relationship and sets some of its features.<sup>185</sup>

In *France*, a mandatary 'is required to accomplish [the mandate] so long as he remains responsible, and responds in damages which may result from its inexecution' (CC article 1991). He answers 'not only for [intentional wrongful acts],<sup>186</sup> but also for faults which he commits in management' (CC article 1992), and 'is required to render an accounting of his management' (CC article 1993). In turn, vis-a-vis the mandator, and irrespective of the success or failure of the task undertaken, provided it acted without fault, the mandatary is entitled to be reimbursed 'for advances and expenses . . . made for the execution of the [mandate]' and to be paid promised wages (CC article 1999). He is also entitled to be indemnified for losses 'sustained during the course of his management without negligence which is imputable to him' (CC article 2000).

<sup>176</sup> For the position in Roman law, see ch 5, section 3, text and nn 41–45 above.

<sup>177</sup> See Lee, above n 161 at 335.

<sup>178</sup> *Ibid* at 287.

<sup>179</sup> R Zimmermann, *The Law of Obligations – Roman Foundations of the Civilian Tradition* (Cape Town: Juta, 1990) at 210.

<sup>180</sup> See discussion by Zimmermann, *ibid* at 426–30.

<sup>181</sup> See Swiss CO art 398 (with reference to arts 321a(1) and 321e(1)); French CC art 1992; Japanese CC art 644; Italian CC art 1710; BGB §276 in Germany; and Quebec CC art 2138. Civil codes discussed in this chapter are cited above in n 93.

<sup>182</sup> Swiss CO art 402(2).

<sup>183</sup> For this development, see Zimmermann, above n 179 at 430–32.

<sup>184</sup> See French CC art 2000; Italian CC art 1720; Japanese CC art 650; and Quebec CC art 2154. In Germany BGB §670 reads to entitle the mandatary to claim from the mandator only expenses (and not losses or damages) incurred by the mandatary in the course of carrying out the mandate. However, '[these] narrow confines . . . were soon left behind by courts and legal writers. The principle of a liability (not based on fault) for risks arising from and connected with activities undertaken by another person in the debtor's interest, is widely acknowledged today.' See Zimmermann, *ibid* at 432.

<sup>185</sup> For the payment order in a credit transfer as a mandate under civil codes see eg Costa, above n 144 at 273 (for Italy); S Iwahara, 'The Practical Execution and Legal Framework of International Funds Transfers in Japan' in Hadding and Schnieder, above n 144 at 289, 299; Thunis, above n 147 at 93 (for France and 'to less extent' Belgium); I Billotte-Tongue, *Aspects Juridiques du Virement Bancaire* (Zurich, Schulthess, 1992) at 31–37, 40–58 (for Switzerland) as well as 30 (for Germany).

<sup>186</sup> Or 'dol' in the original French, which is translated by Crabb, above n 93, less accurately in my view, as 'deceit'.

The general rule under French CC article 1994 is that a mandatary is not answerable to the mandator for a breach committed by a substituted mandatary, except where substitution was unauthorized or where substitution power 'was conferred on him without designation of a person, and the one of whom he made choice was notoriously incapable or insolvent.' Nonetheless, '[i]n all cases the principal may act directly against the person whom the [mandatary] substituted for himself.'

In *Germany*, under BGB §276, 'a debtor [that is, a party liable on a contract, including a mandatary]<sup>187</sup> is responsible . . . for wilful conduct and negligence. A person who does not exercise ordinary care acts negligently.' A mandatary is bound to provide the mandator with information, render an account to him, hand over to him all that he received in connection with the mandate, and pay interest on money for which he is accountable and which he spent to his benefit (BGB §§666–668). He is entitled to receive advances from the mandator for the execution of the mandate as well as to obtain reimbursement for any outlay which he regarded as necessary under the circumstances (BGB §§669–670). While, as a debtor, a mandatary is liable for the fault of an assistant or employee (BGB §278), 'he is responsible only for fault imputable to him' in making a permitted transfer of the mandate, and not otherwise for the fault of the transferee (BGB §664).

In *Switzerland*, under CO article 394(1), '[b]y accepting a mandate, the [mandatary]<sup>188</sup> is obligated to carry out the contractually agreed business transactions or services with which he has been entrusted.' For his part, the mandatary is obligated to render an account to the mandator and transfer to him rights acquired in the course of carrying out the mandate (CO articles 400–401). A mandatary is responsible to the mandator for the faithful and careful performance ('*bonne et fidele execution*') of the mandate (CO article 398(2)). In general, the mandatary is bound by the same standard of care as that of an employee ('*travailleur*') (CO article 398(1)). This standard contains an obligation of diligence and faithfulness (CO article 321a). Treated as an employee, the mandatary is answerable for damage caused to the mandator intentionally or by negligence. The standard of care is determined by contract and circumstances (CO article 321e). Also, any person is liable for damage caused by his employee/assistant ('*auxiliaire*') during the exercise of the latter's function in performing the former's obligation (CO article 101(1)).

Further, in Switzerland, a mandatary is required to carry out his obligations in person. He may, however, be authorized to transfer performance to a third person, whether by contract, under the circumstances, or on the basis of usage (CO article 398(3)).<sup>189</sup> He is also responsible for the acts of a substitute improperly appointed,

<sup>187</sup> For the parties to an obligation as a debtor and creditor, see eg BGB §241.

<sup>188</sup> In fact, the English translation uses 'agent' to denote 'mandatary'. For agency and mandate, see n 161 above.

<sup>189</sup> Cf CO art 68, under which '[a]n obligor is only bound to perform personally where performance depends on his person.'



as well as for the careful selection and instruction of a properly appointed sub-mandatar, but not for the latter's acts and omissions if carefully selected and instructed. A substitute, whether properly appointed or not, is directly responsible to the mandator (CO article 399).

For his part, the mandator is bound to reimburse the mandatar for advances the latter made for the performance of the mandate (CO article 402(2)). At the same time, the mandator is obligated to compensate the mandatar for damage caused by the performance of the mandate only where the mandator is unable to prove that he was not negligent (CO article 402(2)). With respect to this latter point, as already indicated, Switzerland deviates from Roman law doctrine (as accepted by other civil law countries) in effectively establishing reciprocal duties of care between the mandator and the mandatar. In Roman law, the mandator's exposure to losses and damages incurred by the mandatar 'in connection with the performance of' the mandate is irrespective of any negligence on the mandator's part.<sup>190</sup>

In *Italy*, in carrying out customers' instructions, 'the bank is answerable according to the rules concerning mandate' (CC article 1856). As a rule, the mandatar is required to perform the mandate with diligence (CC article 1710(1)). He is further bound to make known to the mandator 'any supervening circumstances which might cause the revocation or modification of the mandate' (CC article 1710(2)). As well, the mandatar is under a duty to render an account for its activities (CC article 1713).

Upon the substitution of a mandatar, the original mandatar remains responsible to the mandator for instructions the former gives the substitute (CC article 1717(3)). However, where substitution was either necessary or authorized, the mandatar is not responsible for the activities of the substitute (CC article 1717(1)). This is true as long as the original mandatar was not at fault in selecting that substitute (CC article 1717(2)). Vicarious liability for default by a properly selected substitute is thus excluded. Under CC article 1856(2), entrusting performance to 'another bank or to one of its correspondents' is explicitly permitted whenever 'the instructions are to be carried out in a place in which the bank has no office.'

In turn, the mandator is bound to furnish the mandatar with the means necessary to perform the mandate, reimburse him for expenses, pay him the remuneration to which he is entitled, and compensate him for damages incurred by him by reason of his undertaking (CC articles 1719–1720).

In *Japan*, a mandatar is bound to manage the affairs entrusted to it 'with the care of a good manager in accordance with the tenor of the mandate' (CC article 644). Namely, the mandatar's liability is for the breach of a duty of care and is not absolute or strict. He is further under a duty to make full disclosure (CC article 645) and account (CC articles 646–647) to the mandator. He is entitled to

<sup>190</sup> For Roman law and the ensuing evolution, see text at nn 176–84 above.

advances or reimbursement for expenditures (CC articles 649–650) as well as to the specially agreed remuneration (CC article 648).

Under Japanese law, the mandate may create an agency relationship (governed by CC articles 99–118) between the mandator (as principal) and mandatary (as agent).<sup>191</sup> Where the commission of the mandate involves tasks carried out by subagents, the Japanese civil code appears to suggest that usually the original mandatary, as agent, is not vicariously liable for the default of a subagent, and that each subagent is liable directly for its own default to the mandator. Thus, according to CC article 104, an agent created by mandate may not appoint a sub-agent, except where the agent has obtained the principal's consent or an unavoidable reason exists. Under CC article 105(1), where the agent has duly appointed a sub-agent, the agent 'shall be responsible to the principal in respect of the appointment and supervision' but not otherwise; that is, vicarious liability for the default by a properly appointed and supervised sub-agent is excluded. Under CC article 105(2), this limited liability for the appointment and supervision of a sub-agent is excluded altogether where the agent has appointed a sub-agent 'as designated by the principal', unless the agent actually knew the designated sub-agent 'to be unfit or untrustworthy' and has neglected to act on the basis of this knowledge. Lastly, under CC article 107(2), '[a] sub-agent has the same rights and duties as the agent towards the principal and third persons.' Thus, the sub-agent is, in effect, a substituted agent.

Finally, under the *Quebec* Civil Code, a mandatary is bound to fulfil the mandate and act 'with prudence and diligence in performing it.' It must further 'act honestly and faithfully in the best interests of the mandator' (CC article 2138). In turn, a mandator is bound to co-operate with the mandatary and cover his costs (CC articles 2149–2151).

In principle, under CC article 2140(1), '[t]he mandatary is bound to fulfill the mandate in person unless he is authorized by the mandator to appoint another person to perform all or part of it in his place.' The appointment of a substitute by the mandatary is also permitted 'where unforeseen circumstances prevent [the mandatary] from fulfilling the mandate and he is unable to inform the mandator thereof in due time' (CC article 2140(2)). Upon an unauthorized substitution, the mandatary remains liable to the mandator for any default by the substitute. At the same time, where substitution has been authorized, the mandatary 'is accountable only for the care with which he selected his substitute and gave him the instructions' but not for the default of a properly selected substitute. In any case, regardless as to whether his appointment has been authorized, the substitute is directly liable to the mandator for its own default (CC article 2141).

<sup>191</sup> See eg CC art 104 (discussed below) referring to an agent created by mandate. Not every mandate creates agency. However, where agency is created by mandate, the mandatary as an agent acts in the name of the mandator/principal. For the distinction between mandate and agency, see n 161 above.

Substitution of a mandatary, under the Quebec civil code, ought however to be distinguished from the appointment of an assistant to whom powers are delegated by the mandatary. The latter is permissible in the performance of the mandate, 'unless prohibited by the mandator or usage.' The mandatary remains liable to the mandator for any default by such an assistant (CC article 2142).

As indicated, while being a civil law concept, in the *common law* the mandate has also been considered as providing the foundation for the cheque drawer-drawee relationship.<sup>192</sup> Moreover, between a customer and his banker, 'it is a historical accident that the mandate normally takes the form of a bill of exchange.'<sup>193</sup> Thus, by extension, the mandate applies to the relationship between the order-giver and order-receiver under any type of payment order.<sup>194</sup> However, unlike the civil law, where the mandate has been broadly perceived as commission to do something for the mandator, the common law views the mandate as merely '[a] direction or request',<sup>195</sup> or as an instruction.<sup>196</sup> Accordingly, in the common law, the mandate did not attract such vast scholarship, doctrine, and jurisprudence as in the civil law. Perhaps it is because of this background that the modern trend in the common law is to analyse the banker and customer relationship on the basis of an implied contract, irrespective of any general mandate doctrine. At the same time, the content of this implied contract has strongly been affected by early court decisions specifically applying mandate doctrine.

In connection with cheques, mandate was possibly first argued in *Hall v Fuller* (1825).<sup>197</sup> Mandate doctrine was specifically applied to the banker and customer in *Young v Grote* (1827).<sup>198</sup> It is noteworthy that the argument in the former and judgment in the latter specifically relied on Pothier.<sup>199</sup> However, for some time, the real meaning,<sup>200</sup> and even the authority,<sup>201</sup> of *Young v Grote* were doubted. Not surprisingly, in rejecting altogether its authority, *Scholfield v Earl of Londesborough* (1896)<sup>202</sup> dismissed the notion that the law of mandate, together with many principle laid down by Pothier, 'forms any part of the mer-

<sup>192</sup> See text and n 158 above.

<sup>193</sup> RST Chorley, 'The Cheque as Mandate and Negotiable Instrument' (1939) *Journal of the Institute of Bankers* 391 at 392.

<sup>194</sup> For a possible extension of the mandate relationship to the entire account relationship (as indeed in Switzerland), see *Greenwood v Martins Bank Ltd* [1932] 1 K.B. 371 at 381–82, per Scrutton LJ, aff'd [1933] A.C. 51.

<sup>195</sup> *Jowitt's Dictionary of English Law*, above n 173 at 1409.

<sup>196</sup> See eg *National Westminster Bank v Barclays Bank International*, above n 174 at 666; and *Barclays Bank v W J Simms Son & Cooke (Southern)*, above n 174 at 699.

<sup>197</sup> (1825) 5 B. & C. 750; 108 E.R. 279.

<sup>198</sup> (1827) 4 Bing. 253; 130 E.R. 764.

<sup>199</sup> See text and nn 168–69 above.

<sup>200</sup> It has been questioned whether the case stood for apparent authority, drawer's duty of care towards all takers of a negotiable instrument, or duty of care owed by a customer to his banker. See Note, 'Careless Spaces on Negotiable Instruments' (1918), 31 *Harvard Law Review* 779.

<sup>201</sup> See eg *Colonial Bank of Australasia v Marshall* [1906] A.C. 559 (P.C.).

<sup>202</sup> [1896] A.C. 514 (H.L.).

cantile law of England'.<sup>203</sup> Ultimately, however, the authority of *Young v Grote*, as based on a mandate and envisaged by Pothier to apply to the banker and customer's relationship, was fully re-established in *London Joint Stock Bank v Macmillan* (1918).<sup>204</sup>

It was thus recognized in *Greenwood v Martins Bank Ltd* (1932)<sup>205</sup> that 'Macmillan's case has laid stress on the relations of banker and customer as giver and executor of a mandate,' under which 'the duties . . . are . . . mutual, to use reasonable care'.<sup>206</sup> Hence, in limiting the customer's responsibility as mandatary to negligence, thereby effectively adopting the minority civil law position (departing on this point from Roman law classic doctrine),<sup>207</sup> the common law came to treat the banker and customer as owing mutual duties of care. As indicated,<sup>208</sup> with the passage of time, and in the absence of a general common law mandate theory, such reciprocal or mutual duties have been characterized as implied terms in contract, irrespective of any mandate doctrine.<sup>209</sup> Reciprocal duties of care between a bank and customer are also established in the United States by the *Uniform Commercial Code*, albeit only in connection with cheques and other paper items.<sup>210</sup>

Creating neither a trust nor an assignment of funds<sup>211</sup> but, rather, being in the common law a mere mandate to pay, the originator's payment order initiating a credit transfer generates 'a string of operations carried out by the different banks acting in a representative capacity'.<sup>212</sup> That is, the legal position of each participant is primarily determined under agency law. The leading case to that effect is *Royal Products Ltd v Midland Bank Ltd* (1981).<sup>213</sup>

In the course of his judgment, Webster J specifically declined to treat the payer-originator's instructions in an interbank transfer as 'any separate or distinct contract of any kind'. Rather, he regarded such instructions

simply as an authority and instruction, from a customer to its bank, to transfer an amount standing to the credit of that customer with that bank to the credit [of the payee-beneficiary] with another bank.

As such, the payer-originator's instructions give rise to 'an ordinary banking operation', namely 'of a kind which is often carried out internally'.<sup>214</sup>

<sup>203</sup> *Ibid* at 524. See also at *ibid* at 531, 532.

<sup>204</sup> *London Joint Stock Bank v Macmillan*, above n 156 at 792, 799, per Lord Finlay LC.

<sup>205</sup> Above n 194.

<sup>206</sup> *Ibid* at 380, per Scrutton LJ.

<sup>207</sup> As discussed in text and nn 176–84 above.

<sup>208</sup> See text that follows n 196 above.

<sup>209</sup> See eg *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd* [1986] A.C. 80 (P.C.). For the replacement of the mandate by implied contract terms, see discussion in B Geva, *Bank Collections*, above n 1 at 355–76.

<sup>210</sup> See eg U.C.C. §3-406.

<sup>211</sup> For the credit transfer as not operating as the assignment of funds, see text and nn 134–38 above.

<sup>212</sup> EP Ellinger, E Lomnicka and RJA Hooley, *Ellinger's Modern Banking Law*, 4th edn (Oxford: Oxford University Press, 2006) at 547.

<sup>213</sup> [1981] 2 Lloyd's Rep. 194.

<sup>214</sup> *Ibid* at 198 (Lloyd's Rep.).

In carrying out the mandate, the payer-originator's bank acts as the payer-originator's agent, owing him 'a duty to use reasonable care and skill.' As such, the bank 'would be vicariously liable for the breach of that duty by any servant or agent to whom [it] delegated the carrying out of the instructions'<sup>215</sup> and thus would be liable for the loss caused by the negligence of any intermediary.<sup>216</sup> As a matter of agency law, the sub-agent is responsible only to the agent and not the original principal; there is neither an agency relationship nor privity of contract between the principal and the sub-agent. Whether or not he had authority to delegate, the agent remains responsible to the principal for the due execution of the mandate.<sup>217</sup>

As discussed earlier,<sup>218</sup> Article 4A of the *Uniform Commercial Code* in the United States is unique in specifically rejecting the mandate as governing the banking relationship in general as well as the payment order in particular. Thus, in a funds transfer, each payment order is a request by the sender to the receiving bank that can be accepted or rejected. A payment order does not create agency or mandate. Nor is it tantamount to the assignment of funds; rather, acceptance by a receiving bank of a sender's payment order generates a contract *sui generis* that does not fall into any established category of relationships. A receiving bank is neither an agent (of the sender, beneficiary or of any other participant), nor an assignee (of the originator's funds at the originator's bank). Acceptance inures solely to the benefit of an immediate party in privity. Thus, acceptance by a receiving bank other than the beneficiary's bank inures to the benefit of the sender; acceptance by the beneficiary's bank inures to the benefit of the beneficiary.<sup>219</sup>

Acceptance by a receiving bank other than the beneficiary's bank is by the execution of the payment order, that is, by the issue of a corresponding payment order, intended to carry out the one received by the bank (*Uniform Commercial Code* §§4A-209 and -301). The executing bank must issue a payment order that conforms to that received by it with respect to the amount, the ultimate destination of the funds, and the identity of any specifically designated intermediary bank. Upon the execution of a payment order, its sender becomes obligated to pay the executing receiving bank the amount of the order (*Uniform Commercial Code* §4A-402(c)). The executing bank's duties as to speed, the means of communication, the use of a funds-transfer system, and the selection of an intermediary bank where none is designated by the sender, are to be carried out with reasonable care and skill (*Uniform Commercial Code* §4A-302). A

<sup>215</sup> *Ibid* at 198 (Lloyd's Rep.).

<sup>216</sup> Under agency law, this holds true even when the use of the sub-agent by the agent is contemplated by, and the particular sub-agent has specifically been nominated at the suggestion of, the principal. See eg *Calico Printers' Association Ltd v Barclays Bank Ltd* (1930) 38 Lloyd's Rep. 105 at 108–11.

<sup>217</sup> See eg R Powell, *The Law of Agency*, 2nd edn (London: Sir Isaac Pitman & Sons, 1961) at 309. But see doubts expressed by Atkin LJ in *Cheshire & Co v Vaughan Bros & Co* [1920] 3 K.B. 240 at 259, particularly where the agent had used reasonable care in selecting the sub-agent.

<sup>218</sup> See text around n 166 above.

<sup>219</sup> See in general U.C.C. §4A-212 (and official comment) as well as §4A-209 Official Comment 1.

bank is neither vicariously liable for the deficient execution by another bank nor liable for its own deficient execution to a participant with whom it is not in privity (*Uniform Commercial Code* §4A-212). As discussed below, under a ‘money-back guarantee’ and regardless of fault, a receiving bank is liable to its own sender for the amount of the order;<sup>220</sup> it is also liable to its sender for expenses and incidental losses, but usually not for consequential losses.<sup>221</sup> For its<sup>222</sup> part, with one major exception relating to a higher duty in connection with unauthorized, but properly verified, payment orders,<sup>223</sup> the customer owes to the bank a duty of care, and yet only for the verification of statements; in the case of breach of such duties, its loss varies between interest and principal.<sup>224</sup>

Indeed, as a general framework for the relationship under the payment order, the drafters of Article 4A rejected the mandate. At the same time, it seems to me, it is certainly the contents of the mandate relationship that guided the drafters in setting the elements of the receiving bank’s obligation to the sender.

In one foremost respect, major legal systems on both sides of the Atlantic deviated from the mandate allocation of liability scheme. This was done by the introduction of a ‘no-fault’ money-back guarantee scheme under which the originator of a credit transfer becomes entitled to a refund for an abortive payment transaction.

Thus, in the United States, under the *Uniform Commercial Code* §4A-402, the acceptance of a payment order by a receiving bank obliges the sender to pay the amount of the order. However, under what came to be known as the ‘money-back guarantee’ rule,<sup>225</sup> payment by the sender is excused, or can be refunded to it, where the funds transfer is not completed. Nonetheless, an originator that selected a failed intermediary bank is responsible for the amount prepaid by the sender to that bank. Otherwise, where loss occurred at an intermediary bank, the effect of the money-back guarantee rule is to shift the risk of loss away from the originator and to place it on the sender to the insolvent bank, regardless of whether loss was caused by a breach of duty.

Similarly, in the European Union, under PSD article 75(1), in principle, the payer’s ‘payment service provider shall . . . be liable to the payer for correct execution of the payment transaction.’ Effectively, the payer’s payment service provider is discharged at the point of time in which ‘the payee’s payment service provider [timely] received the amount of the payment transaction . . .’<sup>226</sup> A payer’s payment service provider in breach of its obligation

<sup>220</sup> U.C.C. §4A-402(e) and Official Comment 2.

<sup>221</sup> U.C.C. §§4A-212, -303, and -305. Scope of liability may however be expanded ‘by express agreement’ (§4A-212), or in order to be liable for consequential losses, by means of ‘an express written agreement of the receiving bank’ (§4A-305(d)).

<sup>222</sup> I am following the usage of U.C.C. Article 4A that, in focusing on corporate customers, uses this pronoun.

<sup>223</sup> See U.C.C. §§4A-202 and -203.

<sup>224</sup> See U.C.C. §§4A-204, -205, and -505.

<sup>225</sup> See U.C.C. §4A-402 Official Comment 2.

<sup>226</sup> As specified in PSD art 75(1).

shall without undue delay refund to the payer the amount of the non-executed or defective payment transaction and, where applicable, restore the debited payment amount to the state in which it would have been had the defective payment transaction not taken place.

Stated otherwise, the payer is entitled to a ‘money-back guarantee’ from the payer’s payment-service provider in case funds do not reach the payee’s payment-service provider.

Under the *Uniform Commercial Code* Article 4A the ‘money-back guarantee rule’ effectively supersedes both (i) fault-based liability allocation under the mandate and (ii) contract liability for foreseeable consequential losses. This is unlike the PSD, where in principle the ‘money-back guarantee rule’ co-exists with mandate and contract damages rules as applicable under the general law of each jurisdiction.

## 6. PAYMASTER’S OBLIGATION: AUTONOMY AND DISCHARGE

As discussed in chapter one, section 4 above, in executing the payer’s payment order, the paymaster may pay the payee either in cash or by causing the payee’s account with the payee’s bank to be credited. In the latter case, payment is in ‘bank money’, referred to in chapter one, section 2, and discussed in chapter ten, section 5 above. As explained in chapter one, section 4.2(iv) above, the process of payment in ‘bank money’ is fundamentally that of substitution of the payer’s original debt to the payee by a new debt of the payee’s bank to the payee. The key to the payer’s discharge towards the payee is thus the accrual of the debt owed by the payee’s bank to the payee, so as to replace the payer’s debt to the payee.

For example, the contract between the payer and the payee may require the former to make payment in cash to a designated bank account. This contract term is understood to allow the payer to use ‘any commercially recognised method of transferring funds, the result of which is to give the transferee [the payee] the unconditional right to the immediate use of the funds transferred.’<sup>227</sup> Conferring on the payee such a right would not be a mere tender, namely, as discussed in chapter one, section 3.2 above, an ‘attempted performance’, denoting a stage where the debtor has done everything which does not require the creditor’s co-operation towards performance.<sup>227.1</sup> Rather, this would constitute ‘payment’ equivalent to payment in money as discussed in chapter one, section 3.3 above, in the same way as ‘handing over coins or banknotes’ to the payee’s bank would constitute payment to the payee.<sup>228</sup>

<sup>227</sup> *The Brimnes Tenax Steamship Co Ltd v The Brimnes (Owners)* [1973] 1 All E.R. 769 at 782 (Q.B.), aff’d on that point, [1974] 3 All E.R. 88 (C.A.) (hereafter: *The Brimnes*).

<sup>227.1</sup> Cf AV Levontin, ‘Debt and Contract in the Common Law’ (1966), 1 *Israel Law Review* 60 at 91, fn 148 where ‘tender’ is explained as being ‘as much performance as lies in the debtor’s hands.’

<sup>228</sup> *Mardorf Peach & Co v Attica Sea Carriers Corp of Liberia (The Laconia)* [1976] 2 All E.R. 249 at 257 (appeal taken from Q.B.D.), rev’d, [1977] 1 All E.R. 545 (H.L.) (explaining that ‘[n]owadays financial obligations . . . are not normally discharged by handing over coins or banknotes.’).



The 'unconditional right to the immediate use of the funds transferred'<sup>229</sup> is an 'unrestricted and unfettered'<sup>230</sup> right on a debt owed to the payee by his own bank, signifying the completion of the funds transfer. For the payee, this debt replaces altogether the payer's original debt to him. As explained below, the exact point of time for the accrual of the right in the payee's favour against his bank is determined under the rules governing the particular payment mechanism; mostly, accrual depends on whether the payment mechanism is a debit or credit transfer.<sup>231</sup>

In principle, in a debit transfer, this point of time coincides with the accountability of the payer's bank. This takes place either upon the irreversibility of the debit to the payer's account on the books of the payer's bank, or at the expiry of the time period during which the payer's bank may return an unpaid item.

At the same time, in a credit transfer, the payer's debt to the payee is discharged when the payee's bank becomes irrevocably indebted to the payee. In general, the occurrence of such an irrevocable engagement to the payee is associated with the acceptance by the payee's bank of payment from the participant who instructed it to pay the payee. In a multilateral interbank clearing setting, clearing rules determine the time such payment to the payee's bank occurs. Alternatively, in a bilateral setting, the payee's bank accepts payment by either (i) debiting the account of the participant who instructed him to pay the payee, or (ii) having a credit posted to its own account with a bank.<sup>231.1</sup> Typically, the bank that will credit the account of the payee's bank is the bank that instructed the payee's bank to pay the payee.<sup>232</sup>

However, as discussed in chapter one, section 4.4 above, particularly in retail transactions, there are situations in which, regardless of the lack of, or prior to, the completion of the funds transfer, and regardless of whether this is a debit or credit transfer, a payee is prepared to accept an obligation of the paymaster, namely, the payer's bank, in discharge of the payer's debt to the payee. In such cases, two questions arise.

The first question is whether the paymaster's obligation is autonomous, that is, enforceable by the creditor to the full amount stated, so as to be free of defences available to the paymaster against the debtor as well as from defences available to the debtor against the creditor.

The second question is whether the paymaster's obligation is accepted by the payee in absolute or conditional discharge of the payer's debt to the payee. In the latter case, the payer's discharge is conditional upon the actual payment, usually in the form of completing the funds transfer. The characterization of the discharge as either absolute or conditional becomes relevant upon the

<sup>229</sup> *The Brimmes*, above n 227 at 782.

<sup>230</sup> The expression is taken from *A/S Awilco v Fulvia SPA di Navigazione (The Chikuma)* [1981] 1 Lloyd's Rep. 371 at 375 (H.L.).

<sup>231</sup> For the distinction, see ch 1, section 4.1(ii) above.

<sup>231.1</sup> For the second option to be effective, the payee's bank must have consented to that credit.

<sup>232</sup> On this subject, in connection with both debit and credit transfers, see in general Geva, 'Payment Finality', above n 115.

default by the paymaster. Upon the occurrence of such default, the payee is left with an action only against the paymaster in the case of an absolute discharge, and against both the payer and the paymaster in the case of a conditional discharge.

There is no correlation between the two questions. For example, as will be discussed below, under modern law, the issuer's obligation on a letter of credit is autonomous; the same may be true for the credit card, at least in the absence of specific legislation to the contrary. However, payment by letter of credit is deemed conditional while payment by credit card may be deemed absolute.

As well, the second question, concerning the discharge achieved by means of a payment mechanism, arises also where the paymaster is not liable at all to the payee. This is relevant when the payment mechanism triggers liability governed by different rules than those on the underlying transaction. Such would be the case where the debtor delivers the creditor either a deed<sup>233</sup> or a cheque. In each case the debtor is the only one liable on the instrument. However, as will be discussed below, at common law, under the deed, which provides for an absolute discharge on the underlying transaction, the debtor forfeits all defences under the transaction. At the same time, on a cheque, which constitutes a conditional discharge, the debtor is presumed to give value (which is not the case when he is sued on his underlying obligation), and may lose his transaction defences against a holder in due course. The present discussion, while focusing on discharge by paymaster obligation, is carried out within the broader context of discharge by payment mechanism.

In this broader context, the effect of a negotiable instrument given in payment of a debt has been addressed by all modern legal systems. In principle, all major systems adhere to a 'conditional payment' presumption under which the issue of an instrument does not extinguish, and yet suspends, the underlying debt.<sup>234</sup>

Thus, regarding civil law jurisdictions, as pointed out in chapter eleven, section 6.3 above, in both *Germany* and *France* the issue of a bill or note does not novate the obligation for which the instrument was given.<sup>235</sup> As for the relationship between the debt and the instrument paying it, French law treats the taking of a negotiable instrument as a double agreement made by the holder. Stated otherwise, by taking a negotiable instrument as a simplified method for the collection of a debt, the holder, first, undertakes not to sue on the underlying

<sup>233</sup> Strictly speaking, the deed is a credit instrument and not a payment mechanism. This is, however, irrelevant for the present purpose.

<sup>234</sup> F Kessler, EH Levi and EE Ferguson, 'Some Aspects of Payment by Negotiable Instrument: A Comparative Study' (1935–36), 45 *Yale Law Journal* 1373. However, there may be differences in detail, as eg, the effect of delay in presentment, or the failure to obtain and send timely protest or give due notice. *Ibid* at 1377–78.

<sup>235</sup> See eg L Dabin, *Fondement du Droit Cambiaire Allemand* (Liège: Faculté de Droit de l'Université de Liège, 1959) at 204–13, 261–66, 334–43, 422–27 (for Germany); Gavalda and Stoufflet, above n 128 at 59–61, 77 (for France); and Ripert and Roblot, above n 128 at 144, 156–60, 216–20 (for France with a comparison to Germany). For an extensive discussion, see Lescot and Roblot, above n 128 at 98–120.

obligation as long as the instrument is not due. Second, he undertakes that, upon default, prior to pursuing other remedies, he will first seek payment on the instrument.<sup>236</sup> However, upon dishonour, the holder is free to sue on either the debt or instrument.<sup>237</sup> Effectively, then, French law provides for a conditional discharge presumption.

Also, German law adheres to a conditional discharge presumption.<sup>238</sup> In principle, dealing with the fulfilment of an obligation, §364(1) of the German Civil Code (BGB) provides for the acceptance by the creditor of 'another performance than the one due.' In turn, §364(2) goes on to speak of the assumption by the debtor 'for the purpose of satisfying the creditor' of 'a new obligation.' The 'performance' under §364(1) extinguishes the obligation. At the same time, the 'new obligation' under §364(2) is not presumed to be assumed 'in lieu of fulfilment.' In this framework, an instrument given in payment of a debt is presumed to be taken by the creditor 'on account of performance' (*erfüllungshalber*), rather than in 'performance' (*Leistung an Erfüllung statt*) of the debt.<sup>239</sup> As a result, and subject to an agreement to the contrary, the underlying debt is not absolutely discharged; rather, upon the taking of the instrument the debt is 'deferred.' Prior to the dishonour of the instrument, the debtor may raise this 'deferral' in defence to an action on the debt.<sup>240</sup> When the instrument is dishonoured, the holder may sue either on the instrument or the debt. Certainly, payment extinguishes the obligation;<sup>241</sup> it is an absolute discharge of the instrument as well as of the debt.

The conditional payment principle also prevails in *England*,<sup>242</sup> albeit in a broader context. A leading modern common law authority is *Re Charge Card Services Ltd* (1988).<sup>243</sup> The discussion in that case was not limited to the effect of payment by negotiable instrument. Rather, in *Charge Card* the court dealt with the broader issue, namely, the effect of the use of any non-cash payment method on the debt paid by it.<sup>244</sup> The court declined to find a 'general principle' governing all circumstances. Rather, '[e]ach method of payment has to be considered in the light of the consequences and other circumstances attending that type of payment.'<sup>245</sup> Bypassing altogether the possibility of two continuously actionable

<sup>236</sup> Ripert and Roblot, *ibid* at 156–57.

<sup>237</sup> Lescot and Roblot, above n 128 at 103–05. The authors express the view that the dishonour of the instrument 'reactivates' the debt regardless of whether the holder complied with formalities required to crystallize liability on the instrument.

<sup>238</sup> Civil codes discussed in this chapter are cited above in n 93.

<sup>239</sup> See eg Dabin, above n 235 at 211.

<sup>240</sup> J Wenzel, §364 no. 7 in FJ Säcker and R. Rixecker (eds), *Münchener Kommentar zum Bürgerlichen Gesetzbuch: BGB Band 2: Schuldrecht Allgemeiner Teil: §§ 241–432* 5th edn. (München: Verlag CH Beck, 2007) [in German]. I relied on an unofficial translation.

<sup>241</sup> BGB §362(1), above n 93.

<sup>242</sup> AG Guest, *Chalmers and Guest on Bills of Exchange, Cheques and Promissory Notes*, 17th edn (London: Sweet & Maxwell, Thomson Reuters, 2009) at 497.

<sup>243</sup> [1988] 3 All E.R. 702 (C.A.) (hereafter: *Charge Card*).

<sup>244</sup> For *Charge Card* and absolute or conditional payment under modern law, see also ch 1, sections 4.2(ii) and 4.4 above.

<sup>245</sup> *Charge Card*, above n 243 at 707.

obligations co-existing with each other, one under the payment obligation and the other on the debt paid by it, the court discussed the availability of two options, namely, either conditional or absolute payment. Accordingly, in connection with the payment of a buyer's debt for goods sold, the court stated:<sup>246</sup>

It is common ground that where a debt is 'paid' by cheque or bill of exchange, there is a presumption that such payment is conditional on the cheque or bill being honoured. If it is not honoured, the condition is not satisfied and the liability of the purchaser to pay the price remains.<sup>247</sup> Such presumption can be rebutted by showing an express or implied intention that the cheque or bill is taken in total satisfaction of the liability.

Arguably, the conditional payment presumption is likely to apply to payment mechanisms under which the paymaster is not obligated to the payee. In such a case, the only liable party is the payer, and the question is the relationship between his liability on the original debt and the obligation on the payment transaction. Under these circumstances, the 'conditional payment' presumption ensures the payer that he may not be sued as long as the instrument has not matured; it also preserves for the payee all remedies under the underlying transaction.

Where the payment transaction is one on which the paymaster is liable, the solution does not appear to be straightforward. Thus, in *WJ Alan & Co Ltd v El Nasr Export & Import Co* (1972)<sup>248</sup> the court ruled<sup>249</sup> that, in a documentary letter of credit transaction, the presumption is that of conditional payment; that is, upon the dishonour of the letter of credit, both the issuer (as well as the confirmer, where such a party exists) and the account party, namely, in the typical documentary credit, the buyer, are liable to the beneficiary (seller of the goods). At the same time, in *Charge Card* itself, the court held that the liability of a credit card issuer is presumed to be absolute, so that the cardholder-buyer cannot be sued by the merchant even upon the insolvency of the issuer.<sup>250</sup>

In connection with a negotiable instrument and letter of credit taken for an underlying transaction (such as the sale of goods), but not a credit card, the point is codified in the *United States* under the *Uniform Commercial Code*. Thus, for letters of credit<sup>251</sup> and negotiable instruments on which the debtor is liable,<sup>252</sup> the conditional presumption applies. At the same time, for negotiable instruments on which a paymaster-bank is liable, the presumption under the *Uniform Commercial Code* is for absolute payment.<sup>253</sup> So far as I can tell, no authoritative statement exists in English common law as to the presumption

<sup>246</sup> *Ibid* at 707.

<sup>247</sup> No opinion was expressed on whether the right to sue on the debt is lost upon the holder's failure to comply with formalities required to crystallize liability on the instrument. On that point, see critical discussion by E McKendrick, *Goode on Commercial Law*, 4th edn (London: Penguin Books, 2010) at 548–49.

<sup>248</sup> [1972] 2 All E.R. 127 (C.A.).

<sup>249</sup> *Ibid* at 139.

<sup>250</sup> Above n 243 at 711.

<sup>251</sup> U.C.C. §2-325.

<sup>252</sup> U.C.C. §3-310(b).

<sup>253</sup> U.C.C. §3-310(a).

applicable in the case of payment by means of a banker's instrument<sup>254</sup> on which a paymaster-bank is liable to the payee.<sup>255</sup> In any event, as a matter of desirable law, it seems to me that if payment by paymaster's obligation is presumed to be conditional, then, upon the paymaster's default, liability of the payer-debtor to the payee is to be reduced by any amount the payer-debtor had prepaid to the paymaster prior to obtaining knowledge of the paymaster's default.

Autonomy has been a basic tenet of the law of letters of credit. Its effect has been to render the issuer/paymaster's obligation to the beneficiary/creditor independent and free from (i) defences the issuer/paymaster may have against the account party/debtor (the issuer's customer) as well as (ii) defences the account party/debtor may have against the creditor on the underlying transaction between them.<sup>255.1</sup> It is the insulation from the latter type of defences which prompted the codification of the autonomy in the United States,<sup>256</sup> its recognition in an international convention,<sup>257</sup> and pronouncement in uniform customs and practice commonly adhered to by parties to a letter of credit transaction.<sup>258</sup>

Under modern law, autonomy of a paymaster's obligation exists in other mechanisms as well, albeit, not necessarily always to the full extent. Thus, the ability of a payee-creditor to enforce liability on a banker's instrument free from defences available to the *banker*-paymaster against his customer, the debtor on the underlying transaction, has been recognized. However, the scope of the creditor's power to recover from the bank the entire amount of the instrument, free from the *debtor's* defences against the creditor, has not been free of doubt.<sup>259</sup>

In turn, a credit card issuer/paymaster is liable to the payee/creditor-merchant notwithstanding any defence the issuer may have against the cardholder, namely, the merchant's debtor. However, in principle,<sup>260</sup> and yet only in the absence of legislation to the contrary,<sup>261</sup> the credit card issuer's obligation is not subject to

<sup>254</sup> Such as a bank draft, certified cheque or money order. See B Geva, 'Irrevocability of Bank Drafts, Certified Cheques and Money Orders' (1986), 65 *Canadian Bar Review* 107.

<sup>255</sup> On the contrary, for the suggestion that the conditional payment principle equally applies to an instrument issued by a 'third person', see Guest, above n 242 at 497.

<sup>255.1</sup> B Kozolchik, 'Letter of Credit' in JS Ziegel, above n 128 (1979) ch 5 at 113, dealing with autonomy under 'abstraction of the letter of credit promise'. For limitations, particularly the fraud exception, see *ibid* at 115-18.

<sup>256</sup> U.C.C. §5-108.

<sup>257</sup> Art 3 of UNCITRAL, *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit*, 11 December 1995, 2169 U.N.T.S. 190 (entered into force 1 January 2000).

<sup>258</sup> See eg art 4 of ICC *Uniform Customs and Practice for Documentary Credits*, 2007 Revision, ICC Publication Number 600 (widely known as the 'UCP 600').

<sup>259</sup> See in general, B Geva, 'The Autonomy of the Banker's Obligation on Bank Drafts and Certified Cheques' (1994), 73 *Canadian Bar Review* 21 at 21-56, and addendum at 280, as well as B Geva, 'Defences on Cheque Certification: *Esses v. Friedberg*' (2009), 24 *Business and Finance Law Review* 359.

<sup>260</sup> Albeit subject to the remote possibility that the 'close-connectedness' doctrine, as may be applied to a purchase-money lender, may apply. See in general, B Geva, *Financing Consumer Sales and Product Defences in Canada and the United States* (Toronto: Carswell, 1984) at 181-91.

<sup>261</sup> See eg, in the US, §170 of the federal *Fair Credit Billing Act*, Pub. L. No. 93-495 (Title III), 88 Stat. 1511, codified at 15 U.S.C §1666-1666(j) (1986), assertion by cardholder against card issuer of claims and defenses arising out of credit card transaction.

defences arising from the underlying transaction between the cardholder and the merchant.<sup>262</sup>

The effect of autonomy is not necessarily limited to the forfeiture of transaction defences. Rather, autonomy will also preclude a paymaster drawer of a bank draft from raising defences based on the unauthorized delivery of the bank draft to the payee. Such would be the case for example where the remitter stole the bank draft from the drawer and paid by it to the payee, to whom the bank draft had been made out.<sup>263</sup> Possibly such is the case even where a thief stole a bank draft, from either the drawer or the remitter, and used it to make a purchase from the named payee for the thief's own benefit.<sup>264</sup> In principle, this is equally true in the case of the issue of the letter of credit on the basis of an unauthorized application of the account party.<sup>265</sup>

Autonomy, otherwise applicable also for a credit card, will not however preclude the paymaster, as an issuer of a credit card, from charging back to the payee-merchant an approved credit card payment<sup>266</sup> made by means of an unauthorized use of the credit card.<sup>267</sup> Stated otherwise, the autonomy of the credit card issuer's obligation is subject to the chargeback provision in the merchant agreement. This is so whether or not the chargeback agreement is between the merchant and the issuer, or between the merchant and another network participant. A pre-existing merchant agreement is present neither in the bank draft nor the letter of credit scenario, so that this exception can arguably be seen as unique to the payment card setting.

However, perhaps more plausibly, the paymaster's absolute liability is excepted for an unauthorized payment in a broader range of cases. Thus, the paymaster may be released in any case in which authentication responsibility lies, at least in part, on the payee. For example, the payee may be required to verify the identity of the payer such as by comparing the latter's signature. Such could be the case not only in a payment card setting; rather it could also be the case in connection with payment by traveller's cheque,<sup>268</sup> regardless of the absence of a pre-existing merchant agreement in this setting. In such a case, the issuer's payment obligation to

<sup>262</sup> This is so since, in extending credit to the cardholder, the credit card issuer is a lender of funds rather than an assignee of the contract for sales financed with the proceeds of the loan. *Harris Trust and Savings Bank v McCray*, 316 N.E.2d 209 (Ill. App. Ct. 1974).

<sup>263</sup> For the delivery presumption in general, see BEA, above n 120, s 21. The text supposes that (i) a payee of a bank draft can be a holder in due course (on the basis of BEA s 31(1), notwithstanding s 31(3)) and that (ii) *National Bank of Canada v Tardivel Associates* (1993), 15 O.R. (3d) 188 (Gen. Div), aff'd (1994), 17 O.R. (3d) 61 (Div. Ct.), holding for the inapplicability of the delivery presumption to the first delivery of an instrument, was wrongly decided.

<sup>264</sup> Albeit, in this case, the payee's claim may founder on lack of good faith (as immediately below) or possibly otherwise in connection with his failure to identify the payee and verify his title.

<sup>265</sup> Certainly, in both cases, a successful payee must have parted with value in good faith on the basis of the bank draft or letter of credit.

<sup>266</sup> Issuer's credit card approval refers to the card, but other than where its use is authenticated by PIN, not to its authorized use.

<sup>267</sup> *Serca Foodservice Inc v Canadian Imperial Bank of Commerce* [2000] O.J. No. 2171, 7 B.L.R. (3d) 47.

<sup>268</sup> For the essential characteristics of the instrument, see eg the definition in U.C.C. §3-104(i).

the payee is to be construed as dependent on the proper verification of payer/remitter's identity by the payee.<sup>269</sup> Upon breach of that obligation, autonomy may not preclude the paymaster from raising defences based on authorized use.

The evolution of rules relating to the autonomy and nature of discharge is not easily traceable. However, awareness and treatment of pertinent issues can be traced to Antiquity. This was particularly so with respect to payment transactions on which the party liable was a third-party paymaster rather than the debtor himself, as in a personal cheque.

Thus, as discussed in chapter five, section 4 above, dealing with the delegation to a paymaster to pay a debt owed by the payer to the payee, *Roman law* addressed both issues, that of autonomy and discharge. In treating the impact of the paymaster's undertaking to execute the delegation by paying the payee, the choice in Roman law was quite limited; it was between the continued existence of the debt owed by the payer to the payee in an imperfect execution of the delegation, and the extinction or absolute discharge of this debt in the perfect execution of the delegation. No middle ground for the suspension or conditional discharge of the payer, until default by the paymaster, appears to have existed. Accordingly, as discussed above in chapter five, section 5, neither the *receptum argentarii* nor the *constitutum debiti alieni* affected the debt for which the *receptum* or *constitutum* was given.

Between these two mechanisms, rules on autonomy differed. Thus, on *receptum argentarii*, the banker-paymaster's obligation was autonomous; namely, it was free of defences that may have been available to the payer against the payee, and enforceable by the payee against the paymaster even when the payer's obligation to the payee was invalid. For its part, however, the *constitutum* promise was not presumed to be autonomous and free of defences arising from the pre-existing debt, including as to its validity.<sup>270</sup>

In contrast to the imperfect execution of the delegation by means of *receptum* or the *constitutum*, the perfect execution of the delegation to pay the payer's debt to the payee by means of the *stipulatio* discharged altogether the underlying debt and left the payee with no cause of action against the payer upon the default of the paymaster. In the case of an absolute (or pure) delegation, the paymaster's obligation to the payee was autonomous, that is, in the entire amount owed by the payer to the payee, and free from the payer's defences against the payee.<sup>271</sup>

Similarly, the book transfer in a *Medieval Continental* bank of deposit provided for an absolute discharge of the debt paid by it; that is, it did not accord to the payee any recourse against the payer upon the default of the paymaster (payer's banker). As well, again in the footsteps of the Roman

<sup>269</sup> It is, however, possible to construe the traveller's cheque issuer's obligation to the payee to pay whenever the counter-signature on the instrument bears adequate resemblance to the pre-existing one, regardless as to whether it is authentic.

<sup>270</sup> Ch 5, section 5 above.

<sup>271</sup> Ch 5, section 6 above.



*stipulatio*, it provided the payee with the benefit of the paymaster's autonomous obligation.<sup>272</sup>

At the same time, in allowing a limited recourse against the payer upon the default of the paymaster, the early *Medieval Islamic hawale* recognized some instances in which a debt is merely suspended and not absolutely discharged by the undertaking of a paymaster to pay the payee. However, this was a rare exception; under all schools of Islamic law recourse was available under extremely narrow and well-defined exceptions. The general rule under the Islamic *hawale*, in the footsteps of the Roman perfect execution of the delegation, was that of an absolute discharge given to the payer, against whom recourse could not be made upon the paymaster's default. In turn, autonomy of the paymaster's obligation was not part of Islamic legal doctrine; rather, depending on the school of law, the paymaster's obligation to the payee was either that of the payer to the payee or that of the paymaster to the payer.<sup>273</sup>

It was pointed out above in chapter eleven<sup>274</sup> that *Medieval English common law* recognized the bond, deed, or bill obligatory as a 'specialty', which was a formal writing under seal on which the debtor was liable in Debt on an Obligation.<sup>275</sup> Being of 'high nature', the undertaking under a specialty contract was divorced from the consideration thereto and could not be varied or contradicted by any extrinsic evidence. 'The defendant was bound by the deed, the whole deed and nothing but the deed.'<sup>276</sup> In the middle of the 15th century it was determined that 'if I am your debtor . . . by a simple contract and I make an obligation to you for the same [amount] on the same contract . . . I am discharged of the contract by obligation.'<sup>277</sup> Stated otherwise, the obligation on the deed was autonomous; as well, it absolutely discharged the debt for which it was given.

The goldsmith's note did not trigger discussion as to autonomy, which apparently was presumed to exist. At the same time, it provoked an extensive discussion on 'conditional payment'. As was pointed out in chapter ten above,<sup>278</sup> the 'conditional payment' principle was introduced in England for goldsmith's

<sup>272</sup> See ch 8, section 2 above.

<sup>273</sup> See ch 6, text around nn 44–53, 195, 199–200 and 227.

<sup>274</sup> See ch 11, text around nn 51 and 315 above.

<sup>275</sup> For Debt on Obligation, namely, on a document deed under seal, see eg JH Baker, *An Introduction to English Legal History*, 4th edn (London: Butterworths, 2002) at 323–26. See also MM Postan, 'Private Financial Instruments in Medieval England' (1930), reprinted in MM Postan, *Medieval Trade and Finance* (Cambridge: Cambridge University Press, 1973) at 28; and AWB Simpson, 'The Penal Bond with Conditional Defeasance' in *Legal Theory and Legal History: Essays on the Common Law* (London: Hambledon Press, 1987) at 143.

<sup>276</sup> Fifoot, *History*, above n 68 at 231.

<sup>277</sup> *Salman v Barkyng* (1422) Y.B. 1 Hen. VI, reprinted in (1933), 50 Selden Soc. 114 at 115 per Babington J. Note the medieval terminology: 'contract' is not 'promise' but the benefit conferred on the defendant under the transaction. 'Obligation' is the specialty contract. See Fifoot, *History*, *ibid* at 225.

<sup>278</sup> See ch 10, text and nn 69–88 above.

notes with the view to protecting a creditor from the risk of the goldsmith's insolvency.<sup>279</sup>

In an open defiance to the prevailing mercantile view,<sup>280</sup> this principle, as pronounced by Lord Holt in *Ward v Evans* (1702),<sup>281</sup> was premised on the view that, in the absence of agreement to the contrary, 'paper is no payment where there is a precedent debt', so that 'the acceptance [by a creditor] of . . . a [goldsmith's] note is not actual payment.'<sup>282</sup> Rather, under the conditional payment principle, 'when such a note is given in payment, it is always intended to be taken under this condition, to be [absolute] payment [only] if the money be paid thereon'.<sup>283</sup> That condition was dispensed with upon the creditor's failure to demand payment from the goldsmith 'in convenient time'.<sup>284</sup> Stated otherwise, the 'conditional payment' principle meant that, upon the goldsmith's failure, the creditor was entitled to recover from the debtor, provided that timely demand from the goldsmith had been made by the creditor.<sup>285</sup>

The 'conditional payment' principle was stated in *Ward v Evans* (1702) to be limited to the taking of a goldsmith note for a *precedent* debt.<sup>286</sup> At the same time, in that case, Lord Holt agreed that a different presumption applied where goldsmith notes are transferred for a present, namely, *contemporaneous* or simultaneously contracted, debt; thus, 'taking a note for goods sold is a payment, because it was part of the original contract'.<sup>287</sup> It thus appears that the distinction drawn between an antecedent debt and present value was rationalized on the intention of the parties; that is, according to Lord Holt it is only when payment is made for a past debt that conditional payment is intended. Presumably, this is so since, at the time the debt was incurred, payment in cash was agreed, and the mere taking of an instrument was designed to strengthen the creditor's position and not weaken it; it thus did not amount to a waiver of

<sup>279</sup> See in general, Holden, above n 125 at 85–86, 109–11 (who nevertheless appears to overlook the distinction, set out below, between the situation where a goldsmith note was taken for an antecedent and when it was taken for a present debt).

<sup>280</sup> See *Ward v Evans* (1702) 2 Ld. Raym. 928 at 930, 92 E.R. 120 at 121 (K.B.), where Lord Holt CJ stated the rule 'notwithstanding the noise and cry, that it is the use of Lombard-Street, as if the contrary opinion would blow up Lombard-Street'.

<sup>281</sup> *Ibid.*

<sup>282</sup> *Ibid.*

<sup>283</sup> *Ibid.*

<sup>284</sup> *Ibid.* Compare *Tassell and Lee v Lewis* (1701) 1 Ld. Raym. 743 at 744, 91 E.R. 1397 at 1398 (K.B.), where the report cites *Hopkins v Geary* (1702) Hil.1 Ann. B.R. Guildhall. See also *Hill & Al v Lewis* 91 E.R. 124 (1709) 1 Salk. 132, 91 E.R. 124 at 125 (K.B.) where Lord Holt CJ instructed the jury that 'what should be thought convenient time, ought to be according to the usage among traders'.

<sup>285</sup> In fact, on the distinction between a precedent and contemporaneous debt, *Ward v Evans* was preceded by *Anon* (1701) Holt. K.B. 298 at 298–99, 90 E.R. 1064. However, in *Anon, ibid.*, dealing with a seller of goods who took a goldsmith note subsequent to the sale and who delayed presentment until after the goldsmith's presentment, Lord Holt nevertheless allowed him to sue the buyer on 'the debt upon the original contract' but not the 'bill'. It is noteworthy that he used 'note' and 'bill' interchangeably as well as referring to the maker of the banknote as the drawee who was instructed to pay by his customer the buyer of the goods.

<sup>286</sup> Above n 280 at 930 (Ld. Raym.), 121 (E.R.).

<sup>287</sup> *Ibid.*

the right to obtain cash payment, albeit on the instrument. In contrast, according to that logic, a creditor who takes a goldsmith note for a present debt indicated his readiness to be satisfied with the goldsmith's liability, and in the absence of specific circumstances to the contrary in a given case, is thus deemed to have never sought the payment obligation of the party who delivered the goldsmith note.

The logic of this distinction is not infallible; in fact, for an obligation of a banker on an instrument, albeit not in itself money, there is nothing to suggest that the distinction between a precedent and contemporaneous debt is still valid.<sup>288</sup> However, having been repeatedly stated by Lord Holt,<sup>289</sup> English cases decided throughout the eighteenth and nineteenth centuries fully adopted his distinction. They thus held that the delivery, against a contemporaneous debt (namely, present value), by a debtor to his creditor, of an instrument on which a third party, not necessarily a banker, was liable, was presumed to be in full discharge. Stated otherwise, on its own, the transaction was a sale of the instrument for the contemporaneous debt, without a warranty or any other undertaking by the instrument 'seller' as to payment by the third party liable on the instrument.

Throughout the nineteenth century, the 'conditional payment' principle did not fare well in the *United States*, where no well-defined territory was carved out for it.<sup>290</sup> Some cases adhered to it.<sup>291</sup> However, it appears that not everybody was convinced by the inherent logic of Lord Holt's distinction. As well, it is possible to speculate that the absence of any substitute in the form of central bank notes may have led some to aspire to a finality rule also for payment in paper. Be that as it may, some cases disregarded Lord Holt's distinction altogether, and opted for a final and absolute, namely unconditional, payment presumption. Among them, some held that this payment finality presumption always applied.<sup>292</sup> Others excepted from it banknotes of a bank that had failed by the time its banknotes were taken by the creditor.<sup>293</sup> In such a case, that is, of a failed bank, and only then, the 'conditional payment' principle was said to apply. For courts that did not adhere to Lord Holt's distinction, all this was regardless of whether the note was taken for a precedent or contemporaneous debt.<sup>294</sup> In the absence of a 'conditional payment' principle, creditors taking banknotes had to rely exclusively on the creditworthiness of the banker liable

<sup>288</sup> Guest, above n 242 at 490.

<sup>289</sup> See eg *Clerk v Mundall* (1700) 12 Mod. 203, 88 E.R. 1263; and *Bank of England v Newman* (1700) 12 Mod. 241, 88 E.R. 1290. Cf *Anon* (1701), above n 285.

<sup>290</sup> For an exhaustive summary, against the background of the English precedents, on which the ensuing discussion draws, see JS Rogers, 'The New Old Law of Electronic Money' (2005), 58 *Southern Methodist University Law Review* 1253 at 1287–97.

<sup>291</sup> See eg *Corbit v Bank of Smyrna* 2 Harr. 235 (Del. 1837).

<sup>292</sup> See eg *Scruggs v Gass* 16 Tenn. 175 (1835); and *Lourey v Murrell* 2 Port. 280 (Ala. 1835).

<sup>293</sup> The leading case is *Ontario Bank v Lightbody* 13 Wend. 101 (N.Y. 1834).

<sup>294</sup> In the US, complication of the issue only progressed, as the line between precedent and contemporaneous debts became blurred. See eg *Hall v Stevens* 116 N.Y. 201, 22 N.E. 374 (Supp. Ct. 1889).

on the instrument. At present, the 'absolute payment' presumption, ultimately accorded by the American *Uniform Commercial Code* to instruments on which a bank is liable,<sup>295</sup> is associated with payment instruments such as cashier's cheques, teller's cheques and money orders.<sup>296</sup>

For its part, the *Talmud* did not provide any insight relating to the autonomy of the paymaster's obligation. Conversely, the Talmud provoked insightful discussions on the nature of discharge accorded by a payment mechanism. Chapter four above discussed what is possibly the earliest source addressing, and forming a basis for a subsequent extensive discussion on, a conditional payment theory. This source is the *Bava Metzia* Talmudic text dealing with the position of a worker-creditor who was sent by his employer-debtor to obtain wages from a paymaster extending credit to the employer.<sup>297</sup>

The specific issue discussed was the availability to the worker-creditor of recourse against the employer-debtor upon the default of the paymaster. The discussion revolved around the actual agreement of the parties. Accordingly, it was 'obvious' that (a) no recourse is available to the worker-creditor in the case of an express and absolute release of the employer-debtor by the worker-creditor. Conversely, it was obvious that (b) recourse against the employer-debtor is available to the worker-creditor, upon the default of the paymaster, in the case of an express release of the employer-debtor by the worker-creditor, stated to be conditional on the paymaster's default.

Rather, the disputation was discussed in relation to two 'sub-scenarios', namely, (i) one involving an implied absolute discharge by the worker-creditor, and (ii) another, of an express conditional discharge by him. The first sub-scenario was said to take place in the case of a binding and irrevocable obligation of the paymaster towards the worker-creditor. At the same time, discussion on the second sub-scenario did not necessarily assume a paymaster's binding engagement towards the worker-creditor.

In connection with the second sub-scenario, the disputation was concerned with the suspension of the employer-debtor's obligation until the paymaster's default. Stated otherwise, the choice was not between conditional and absolute discharge; rather, it was between conditional discharge and continued liability of the employer-debtor to the worker-creditor. 'Continued liability' was said to be uninterrupted and 'unsuspended', irrespective of the worker-creditor's agreement to look to the paymaster for actual payment. In the second sub-scenario, rejection of suspension, and hence conditional payment, was premised on the absence of a binding paymaster's payment obligation; and yet, conditional payment, argued by one of the Rabbis, could work regardless of the binding effect of the paymaster's engagement.

As discussed in chapter seven, section 3 above, the question of conditional discharge arose in post-Talmudic Medieval commentary in connection with

<sup>295</sup> See text at n 253 above.

<sup>296</sup> For these instruments, see U.C.C. §3-104.

<sup>297</sup> Talmud, *Bava Metzia* at 111A and 112A.

another Talmudic text, dealing with the instruction given to a paymaster to pay a creditor by means of an in-the-presence-of-three declaration. In this setting, the Gemara in *Gitin*<sup>298</sup> quotes Rav Huna to say, in Rav's name, that if one person instructs another who owes him money to give that money to a third party, that third party thereby acquires the right to that money. However, this is true only as long as all three of them are present together at the time the instruction is given. Several controversies were raised in connection with the Talmudic presence-of-all-three declaration. The fourth of them relates to the discharge accorded by the declaration to the debtor towards the creditor, to whom the paymaster was instructed to pay. Upon the default of the paymaster, one view supports an absolute discharge so that no recourse is available to the creditor against the debtor; the other supports a conditional discharge, so that recourse from the debtor is available to the creditor upon the default of the paymaster.<sup>299</sup>

In essence, this Talmudic controversy is on the presumed intention of the creditor. Stated otherwise, the controversy is on the effect of the silence of the creditor, the beneficiary of the declaration, or even his express acceptance of the declaration, unaccompanied by an elaboration as to its terms. Is it to be interpreted as an acceptance of the paymaster's debt in absolute discharge, or merely as a conditional discharge, of the debt owed to him by the debtor?

In the final analysis, Talmudic law distinguished itself in having an extensive discussion on the discharge accorded by a paymaster's obligation. Arguably, the question arose in Talmudic law ahead of its time and for that reason actual resolution is neither decisive nor necessarily always satisfactory. In the absence of practical applications to sophisticated payment mechanisms at the relevant eras, solutions based on advanced legal thinking were simply premature.

As indicated in chapter five above, *Roman law* provides building blocks for the operation of a payment mechanism. Two such building blocks are the *cessio* and the *delegatio*. However, as discussed below, even in their present configurations under modern civil codes<sup>300</sup> both doctrines failed to provide a complete legal framework for dealing with the scope and impact of the paymaster's obligation.

As discussed above in chapter five, section 9, *cessio*, or the assignment of debts, bypasses the paymaster's agreement. Its operation is premised on the power the debtor gives the creditor to collect from the paymaster a debt owed by the paymaster to the debtor and keep the proceeds in discharge of the debt the debtor owes the creditor.

Under *cessio*, following an evolutionary process that goes back to Roman law,<sup>301</sup> the paymaster remains liable on his own original obligation, though to a

<sup>298</sup> Talmud, *Gitin* at 13A.

<sup>299</sup> See Shulchan Aruch, *Choshen Mishpat*, Section 126, Rule 9.

<sup>300</sup> Civil codes discussed in this chapter are cited above in n 93.

<sup>301</sup> Evolution is outlined by Lee, above n 161 at 410–12; B Nicholas, *An Introduction to Roman Law* (Oxford: Clarendon Press, 1962) at 200–01; and Zimmermann, above n 179 at 58–64. For a detailed account, see Demangeat, A, *Droit Romain: De la Cession de Créances. Droit des Gens: De la Jurisdiction en Matière de Prises Maritimes* (Paris: A Giard, Libraire-Éditeur, 1890) at 13–33 (in *Droit Romain*). See also Duponchel, above n 153 at 3–10.

new creditor. The paymaster may thus raise, against the creditor, defences that would have been available to the paymaster against the debtor. As well, the creditor becomes entitled to the paymaster's securities given to the debtor.<sup>302</sup> Arguably, it is the lack of autonomy of the paymaster's obligation, namely, the subjection of the creditor's claim to the paymaster's defences against the debtor, that hinders the development of assignment to become an overarching theory underlying the operation of a payment mechanism.

However, lack of autonomy has not been the only hurdle for the limited role that the assignment of debt has played in the development of a legal doctrine governing payment mechanisms. Another hindrance has been the absence of clear rules as to the nature of the discharge accorded to the debtor's debt to the creditor.

For example, regarding discharge, Duponchel<sup>303</sup> distinguishes between *cessio* and *assignatio*; the former is effectively an assignment without recourse, and the latter, which can be translated as 'assignation',<sup>304</sup> is an assignment with recourse. As Duponchel explains, what discharges the debtor's debt to the creditor is the paymaster's debt to the debtor in a cession, and actual payment by the paymaster (or the debtor) to the creditor in an assignation.<sup>305</sup> In an assignation, in the absence of actual payment, the debtor remains liable to the creditor, even if only contingently, upon the default by the paymaster. However, Duponchel does not discuss the position that exists in the absence of a clear agreement on the recourse point. Where the debtor-assignor and creditor-assignee are silent on the point, (i) is the assignment without recourse, so as to provide the debtor with an absolute discharge? Alternatively, (ii) is the assignment conditional, in which case is the debtor's discharge only provisional, pending actual payment by the paymaster? The absence of clear rules<sup>306</sup> precludes an orderly development of the assignment as a doctrine explaining the operation of payment mechanisms.

<sup>302</sup> See eg Swiss CO arts 169 (defences) and 170 (securities); French CC art 1692 (securities); German BGB §§404 (defences) and 401 (securities); Quebec CC arts 1643 (defences) and 1638 (securities); and Italian CC art 1263 (securities).

<sup>303</sup> Above n 153 at 10.

<sup>304</sup> Terminology on the point is, however, quite confusing. Eg, in Scotland, 'assignation' is used to denote 'assignment.' See eg *Glossary of Scottish and European Union Legal Terms and Latin Phrases*, 2nd edn (Edinburgh: The Law Society of Scotland & Lexis-Nexis UK, 2003), defining at 17 'assignation' as the 'act of transferring rights in incorporeal moveable property from one party to another' or 'the document transferring such rights.' See also *British Linen Co v Hay & Robertson and Broun* (1885) 22 S.L.R. 542 (First Division); and J Bouvier, *A Law Dictionary: adapted to the constitution and laws of the United States of America, and of the several states of the American Union*, rev 6th edn (1856), online: Constitution Society [www.constitution.org/bouv/bouvier.htm](http://www.constitution.org/bouv/bouvier.htm), defining 'assignation' in Scottish law to be '[t]he ceding or yielding a thing to another of which intimation must be made.' At the same time, the Swiss CO distinguishes (in French) between '*assignation*' and '*cession*' (arts 466 and 164 respectively), the former being an order or authorization to pay and the latter being an assignment of a right.

<sup>305</sup> Indeed, as Duponchel points out (above n 153 at 10), in an assignation the creditor does not assume the risk of the paymaster's default and, as such, his position, unlike under a cession, is analogous to that of a mandatary. Nevertheless, inasmuch as collection by the creditor from the paymaster is for his own benefit and not for that of the debtor, the assignation is not a true mandate.

<sup>306</sup> An absolute discharge presumption exists in Italy where, under CC art 1198, 'unless it appears

Delegation fared better than the assignment of debts in explaining the scope and impact of the paymaster's obligation; yet its success has not been unlimited.<sup>307</sup> Indeed, a central theme of chapter five, sections 4–7 above, was the promise embodied in the Roman law delegation. Unfortunately, existing provisions of civil codes in various major jurisdictions dealing with the delegation and the assumption of an obligation do not provide an adequate framework for dealing with the paymaster's obligation. This could have been predicted from developments outlined above in chapter five, section 8, following the state of law already in existence at the time of Justinian.

Particularly, consistency as to the novatory impact of delegation has been lost.<sup>308</sup> However, these provisions point at the possibility of resolving underlying issues by means of principles derived from legal doctrine in Antiquity. An outline of these provisions is hereby given.<sup>309</sup>

An assumption of an obligation is dealt with in the *Swiss* Code of Obligations in articles 175–180. Thereunder, an assumption of an obligation is to be promised by the paymaster to the debtor and agreed to by the creditor. Under CO article 176, the assumption of the obligation is in lieu of, and in discharge of, the previous debtor. This suggests an absolute rather than conditional discharge for the debtor towards the creditor. For its part, the obligation undertaken by the paymaster is not autonomous. Thus, as against the creditor, the paymaster may raise defences available to the debtor under the obligation assumed by the paymaster. At the same time, the paymaster may raise neither the debtor's personal defences nor the paymaster's defences against the debtor (CO article 179). 'Ancillary rights', that is, proprietary securities given by the debtor to the creditor, survive the assumption of the obligation; in principle, this is not so for personal securities, such as guarantees, and proprietary securities given by a third party, which extinguish (CO article 178).

Under the *French* Civil Code, the delegation,<sup>310</sup> under which the debtor provides the creditor with another debtor (that is, in our parlance, a paymaster) operates as a novation only where the creditor expressly states he is discharging the debtor. The presumption then is of a continuation of the debtor's obligation to the creditor (CC article 1275). Stated otherwise, both perfect and imperfect executions<sup>311</sup> are recognized, except that the presumption is of the imperfect

that the parties had a different intention' the assignment of a claim 'in lieu of the performance of an obligation' is deemed to extinguish the obligation. French CC arts 1694 and 1695, stating that, in the absence of an agreement to the contrary, the debtor does not warrant the paymaster's solvency, and even when such a warranty is made it applies only to the day of the assignment itself, are effectively to the contrary.

<sup>307</sup> This is also the opinion of Thunis, above n 147 at 109, who in the context of the card payment speaks of the delegation as 'a very partial solution'.

<sup>308</sup> For the 'non-novatory delegation', see eg Sorbier, above n 155 at 25–26.

<sup>309</sup> Civil codes discussed in this chapter are cited above in n 93.

<sup>310</sup> Regrettably, the English translation (above n 93) speaks of 'assignment' instead of 'delegation'.

<sup>311</sup> For these two types of executions and their legal ramifications under Roman law, see ch 5, sections 4–7 above.



one. In the case of a perfect execution, namely, novation under which the debtor is fully discharged, recourse by the creditor against the debtor is nevertheless available, albeit only in exceptional circumstances. Such circumstances involve the paymaster's insolvency, and even then, recourse against the debtor is available only as long as either it was agreed, or where the paymaster was insolvent already at the time of the delegation (CC article 1276). In principle, the discharge of the debtor entails the extinction of securities given by the debtor (CC article 1278) and does not provide for an automatic attachment to the paymaster's assets as securities for his own obligation to the creditor (CC article 1279).

The *Italian* Civil Code provides for the case in which the paymaster, delegated by the debtor, binds himself to the creditor. In such a case, unless the creditor declares otherwise, the debtor's obligation is not absolutely discharged. Rather, it is suspended. During its suspension, the creditor who has accepted the paymaster's obligation 'has no remedy against the [debtor] unless he has previously requested payment from the [paymaster]' (CC article 1268).<sup>312</sup> Revocation is available to the debtor until the paymaster has assumed or discharged the obligation to the creditor (CC article 1270). Where the paymaster becomes obligated to the creditor, subject to an agreement to the contrary, his obligation is autonomous; neither his own defences against the debtor, nor the debtor's defences against the creditor, are available to him against the creditor's claim (CC article 1271).

In *Quebec*, the delegation is constituted whenever the paymaster, nominated by the debtor, 'obligates himself personally' to the creditor (CC article 1667). The acceptance by the creditor of the paymaster as a new debtor, is not deemed to constitute release of the original debtor; that is, no absolute discharge is presumed to have taken place (CC article 1668). In principle, the debtor's defences against the creditor, but not the paymaster's defences against the debtor, are available to the paymaster against the creditor's claim.<sup>313</sup>

## 7. CONCLUSION: A 'REVISIONIST' VIEW ON A 'DECENTRALIZED' NON-CUSTOMARY 'LAW MERCHANT'

Concluding an extensive article,<sup>314</sup> Dalhuisen puts 'fundamental legal principle' at the top of the hierarchy of 'the sources of law in the international commercial and financial legal order'.<sup>315</sup> At the same time, he opens that same article speaking of 'a spontaneous new transnational law merchant, or *lex mercatoria*, substantially

<sup>312</sup> Under CC art 1269, the debtor may forbid the paymaster to bind himself to the creditor. For his part, the paymaster is not bound 'to accept the obligation' even if he is indebted to the debtor. *Ibid.*

<sup>313</sup> Quebec CC arts 1669–1670.

<sup>314</sup> JH Dalhuisen, 'Legal Orders and Their Manifestation: The Operation of the International Commercial and Financial Legal Order and Its *Lex Mercatoria*' (2006), 24 *Berkeley Journal of International Law* 129.

<sup>315</sup> *Ibid* at 180.

covering all international commercial and financial transactions', whose 'emergence and content' he nevertheless describes as 'contentious'.<sup>316</sup>

Dealing with payment services and their providers, the bank deposit, the payment order and its execution, the payment order as a mandate, and the scope and effect of the paymaster's obligation, as well as with negotiability, the present study demonstrates the paramountcy of 'fundamental legal principle'. At the same time, the present study does not confirm the existence of a 'spontaneous new transnational law merchant', at least for the subjects researched and discussed in this work. Rather, in line with what has existed throughout history, what I see is the existence of spontaneous innovative practices of 'merchants', conforming to, as well as pushing forward, the frontiers of contemporary political, socio-economic, and institutional orders as well as technological accomplishments. These spontaneous and innovative practices do not make new principles of law; rather, they put demands on the law, pushing its frontiers, in a quest for an adequate response from law makers.

A unique exception, discussed in chapter four, section 7 above, is the treatment by the post-Talmudic Gaonic sages in the early Middle Ages of the Islamic *suftaj* as practised by Jewish traders. Elsewhere the Rabbis pronounced new principles on the basis of the facilitation of commercial transactions;<sup>317</sup> and yet they did not choose to do so in this matter. Rather, in defiance of Talmudic legal doctrine, and without attempting any reconciliation with principle, the sages explicitly 'accepted upon [them]selves to admit the *suftaj* under the law of the merchants'.<sup>318</sup> This is in clear contrast to the enterprise undertaken by English judges of the seventeenth and eighteenth centuries who, as discussed in chapters nine and eleven above, went out of their way to expand the frontiers of liability within the common law to accommodate new financial instruments and techniques. Indeed, this was the usual English judge-made law in operation, rather than a demonstration of 'spontaneous' law 'forced' on judges by merchants.

At the same time, I share Dalhuisen's perspective speaking of 'the international law merchant as non-statist transnational law'.<sup>319</sup> Indeed, in establishing commercial and financial law norms, international borders and sovereignty of nations have played a very small role. Rather, these norms have been the products of transnational legal systems. At any given time, the dominant legal system was that of the mercantile power of the moment and place, which nevertheless had freely borrowed from its predecessors in power, its major neighbours, as well as from its intellectually persuasive contemporaries. Thus, for example, Roman law was followed by Islam, civil law, and the common law. Jewish law has entered the scene by virtue of its deliberate attention to detail, the

<sup>316</sup> *Ibid* at 129.

<sup>317</sup> See eg ch 7, text and n 145, in connection with the dispensation with paymaster consent in a presence-of-all-three declaration.

<sup>318</sup> Gaonic Response No 423, reproduced in AA Harkavy (ed), *Gaonic Reponsa* (NY: Menora, 1959). Response is recorded in the original Judeo-Arabic and Hebrew translation (at 316).

<sup>319</sup> Dalhuisen, above n 314 at 134.

involvement of Jews in global commerce, and the presence of Jews in various commercial centres during 2,000 years of wandering.

Nor do I contest the important role of commercial and financial groups in the emergence of what can be described as that ‘non-statist transnational law’.<sup>320</sup> However, in departure from Dalhuisen’s approach, the present study designates to such groups a role in putting demands on the law rather than in making new law. The ‘transnational law’ generated by meeting these demands is an adaptation of existing principles; it is formulated and adopted by each legal system on its own terms, albeit in each era, under the influence of major legal systems. Variations in detail among resulting national laws are likely to be a mere coincidence, rather than the result of different substantive approaches. Hence the justified impetus and rationale for ongoing harmonization and law reform projects.

A general theme of this book is the development of principles of law in tandem with the evolution of banking and in response to changing circumstances. What I found was collaboration – albeit overwhelmingly unconscious – among the various legal systems in providing similar solutions to similar problems as they have arisen in different places, in different times, and in different cultural, institutional as well as legal contexts. Accordingly, I argue, since the birth of non-cash payment methods, in each legal system there has been a body of law applicable to payment mechanisms. The common origin and nature of the response to similar challenges in the various legal systems has been the basis for a global and transnational, cohesive albeit decentralized, ‘law merchant’. In the process of its emergence and growth, general principles of law evolved, adapted and developed to produce a coherent body of funds transfer and payment law. This body of law has been applied to payment systems throughout history, in diverse places, socio-economic and political orders, as well as technological stages. Premised on old legal doctrines and principles, the transnational law merchant continues to evolve to meet the ongoing needs of a constantly changing global market.

<sup>320</sup> *Ibid.*

## Epilogue: From Barter to Electronic Funds Transfers and the Role of Law

IN HIS SEMINAL work on the early history of bills and notes, Rogers juxtaposes two questions. The first is ‘*What* did [people] use in making payments instead of paper currency or bank credit?’ The second is ‘*how* [did] people engage . . . in economic exchange even though they frequently did not have anything to pass around as payment medium[?]’ (emphasis added). In his view, ‘[i]n examining the mechanisms of payments used before the developments of modern payment media’, the first question is misleading. Accordingly, he explains, the ongoing progression from barter, via ‘commodities such as cattle, animal skins, or salt’, precious metal, and coin, to commercial paper/negotiable instruments, is an anachronistic account; it takes ‘as universal’ what is in fact merely ‘the modern phenomenon of a payment system that is so pervasive and sophisticated that each commercial transaction can be settled by a corresponding payment transaction.’<sup>1</sup>

My own research persuaded me not to share this ranking and characterization of the first question. The starting point of the present study was the inadequacy of self-sufficiency. The study then sketched the evolution of payment in exchange economy from barter, to the use of ‘primitive money’, and onward, to coined money, paper money, bank money and ultimately towards e-money. My observation is that the search for a better medium has generated a search for avoiding an existing medium by instructing a paymaster to pay with the existing medium – and that, at the end of the day, the instrument under which the paymaster has been instructed to pay the old medium may itself have become a new medium. Economic and social conditions, side by side with ongoing technological improvements, led the entire process.

True, progress has not always been linear or unidirectional. However, the choice of what people used has always been made with a view to avoiding scarcity, enhancing liquidity and improving efficiency. I therefore disagree with Rogers’ ranking of the questions. *What* people used, namely Rogers’ first question, has always been part of an ongoing search for an enhanced system. *How* people were engaged in an economic activity, namely, Rogers’ second question, legitimate as it is, is in my view a subsidiary of the first one. On the whole, *how* they managed was instrumental in leading to *what* they used next.

<sup>1</sup> JS Rogers, *The Early History of the Law of Bills and Notes: A Study of the Origins of Anglo-American Commercial Law* (Cambridge: Cambridge University Press, 1995) at 109.

The focus of the present book was on the legal accommodation of the evolution of payment mechanisms. The study focused on the development of principles in Antiquity and the Middle Ages and their influence on modern law. It covered developments in Ancient Mesopotamia, Ancient Greece, Rome, Greco-Roman Egypt, Continental Europe and England. The roots of the modern global payment system, as well as its laws and institutions, were traced in those developments. Doctrine was examined in Jewish, Islamic, Roman, common and civil laws.

What I found was collaboration – albeit overwhelmingly unconscious – among the various legal systems in providing similar solutions to similar problems as they have arisen in different places, in different times, and in different cultural, institutional as well as legal contexts. Accordingly, I argue, since the birth of non-cash payment methods, in each legal system there has been a body of law applicable to payment mechanisms. The common origin and nature of the response to similar challenges in the various legal systems is the global and transnational ‘law merchant’ governing payment transactions.

General principles of law have been applied to payment systems throughout history, in diverse places, different socio-economic and political orders, as well as various technological stages. Over the centuries, such principles evolved, adapted and developed to produce a coherent body of funds transfer and payment law so as to constitute the aforesaid global and transnational ‘law merchant’. Looking forward, I have confidence in the durability of the resulting legal doctrine and its ability to continue to evolve and accommodate future payment system developments in an orderly fashion. However, while during Antiquity and the Middle Ages collaboration among various legal systems was overwhelmingly unconscious and indirect, matters have gradually changed in the modern era. In today’s global environment of instant communication, collaboration and co-operation can be conscious and open. The chances are that the evolving new global and transnational ‘law merchant’ governing payment transactions will remain anchored in the legal doctrine of Antiquity and the Middle Ages. At the same time, this ‘law merchant’ will not only advance, but will also become more harmonized. It will thus evolve to accommodate not only emerging new diverse technologies – but also a truly global payment system, shared by all the people of this planet.

## **Illustrations**

### **General Key**

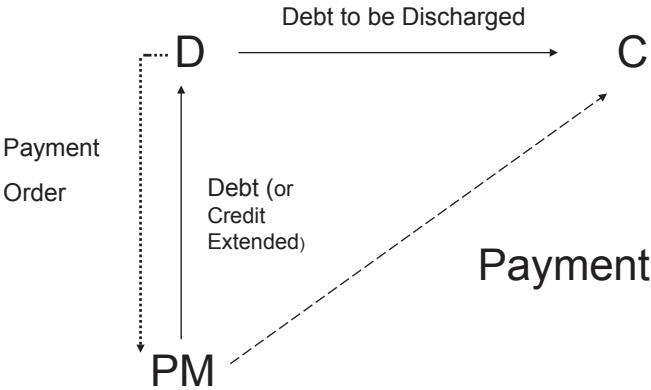
**D – Debtor/Payer**  
**C – Creditor/Payee**  
**PM – Paymaster [usually a ‘bank’]**  
**Cor – Correspondent**

### **Note**

Illustrations are designed to help the reader to follow principal settings as he or she reads throughout the book. The description in the book of each setting is designed to be self-explanatory; at the same time, it is only natural that the use of illustrations will enhance comprehension and facilitate smoother reading.

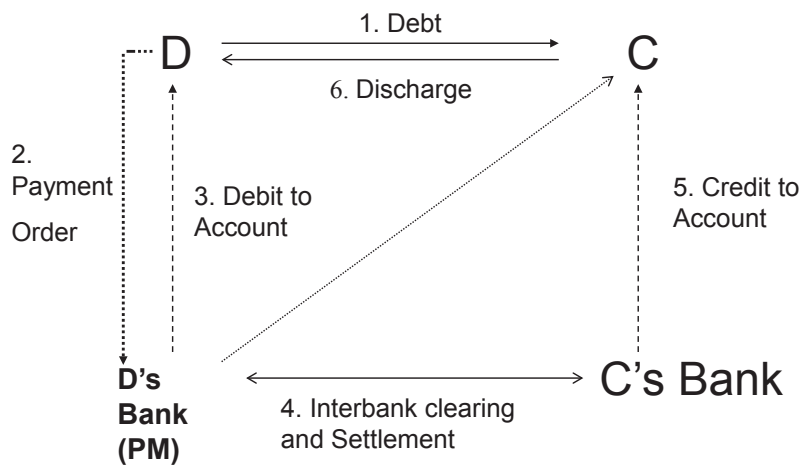
An illustration associated with a specific chapter identifies that chapter. However, several illustrations are ‘versatile’ in the sense that they are relevant for more than two chapters. In such a case they do not specify any particular chapter with which they are associated.

# Operation of a Payment Mechanism

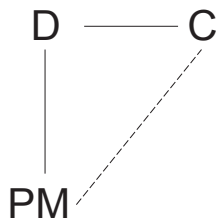




# Payment Through the Banking System

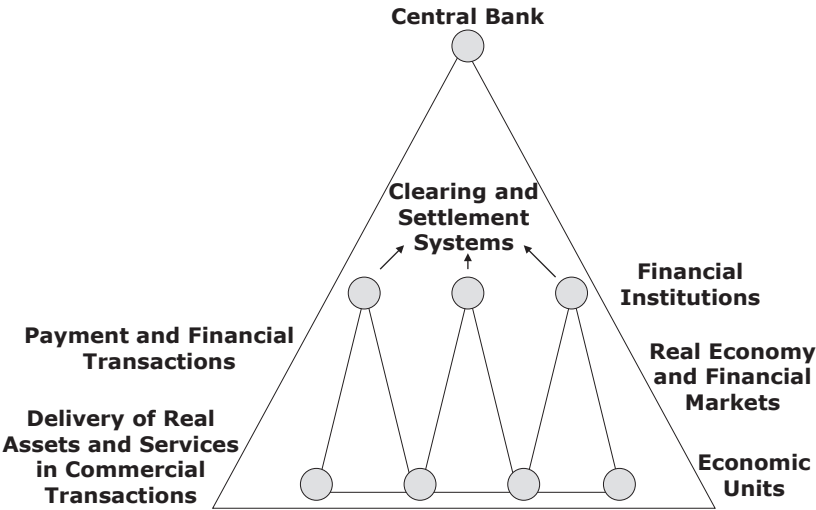


## Payment Mechanism: Major Legal Issues

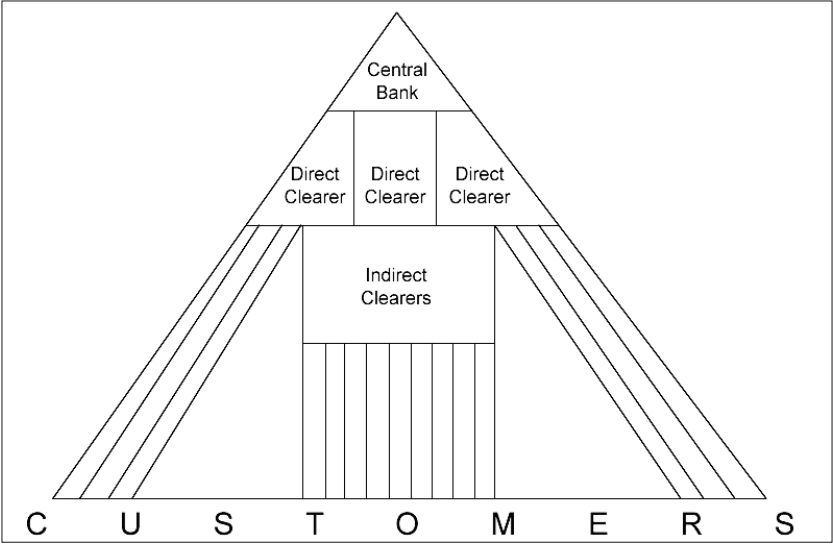


1. C – D: – discharge/recourse
2. Defences available to PM against C's claim

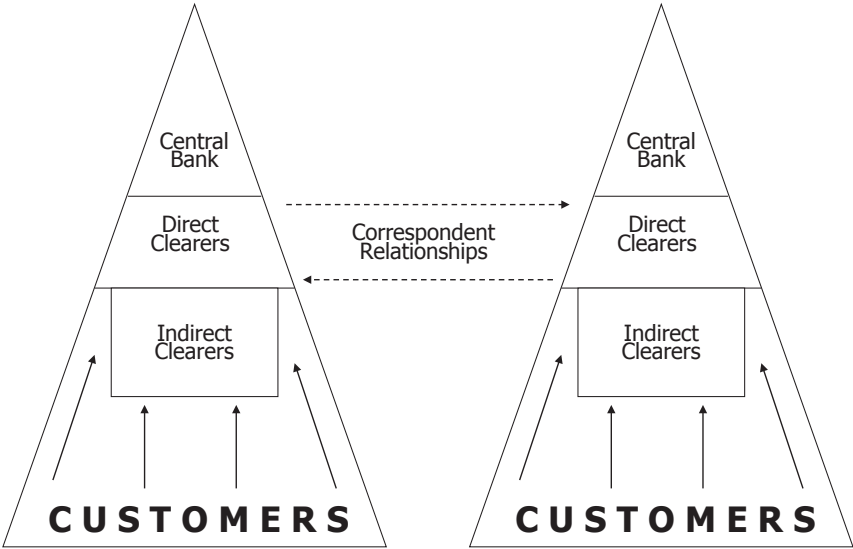
Clearing and Settlement Systems in the National Economy [Prologue and chapter ten]



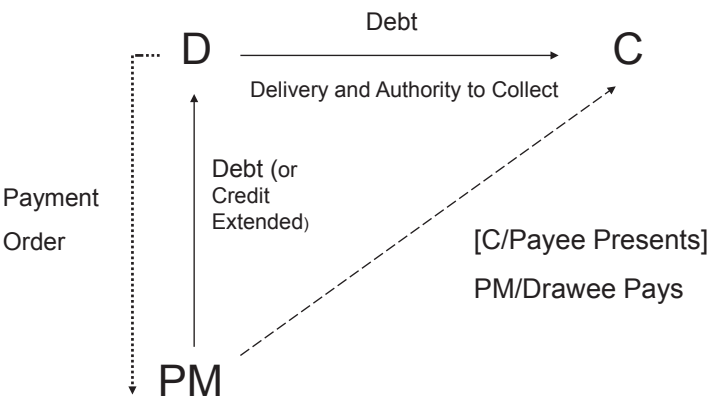
Participants in the Domestic Payment System  
[Prologue and chapter ten]



The International Payment System  
[Prologue and chapter ten]



# The Cheque



- D: Drawer
- C: Payee
- PM: Drawee – ‘banker’

**Drawer** instructs **Drawee** to pay and by issuing cheque to **Payee** authorizes **Payee** to collect from **Drawee** by presenting the cheque to **Drawee**.

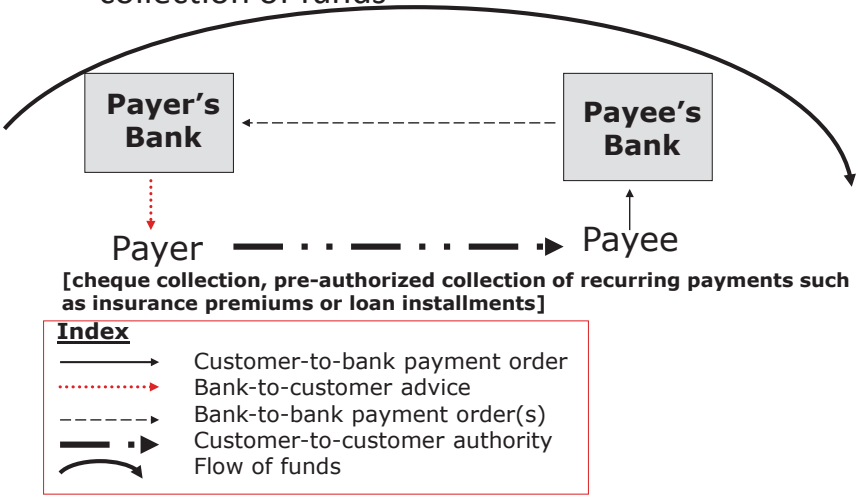
## Funds Transfers

- **Debit transfers**: Collections initiated by the payee (Creditor) through payee's bank (under payer's authority)
- **Credit transfers**: Payments initiated by the payer (Debtor) instructing directly the payer's own bank

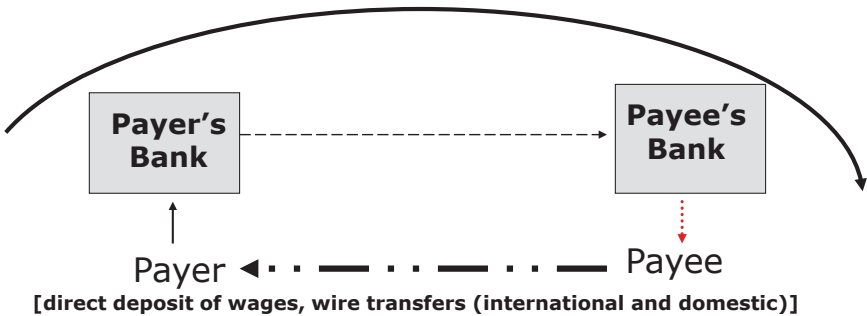


Depending on Communication Flow:  
**Payment Transactions**

Are either **Debit transfers** (debit 'pull') for the collection of funds



Depending on Communication Flow:  
**Payment Transactions**  
Or **Credit Transfers** (credit 'push')



| <u><b>Index</b></u> |                                |
|---------------------|--------------------------------|
|                     | Customer-to-bank payment order |
|                     | Bank-to-customer advice        |
|                     | Bank-to-bank payment order(s)  |
|                     | Customer-to-customer authority |
|                     | Flow of funds                  |

## Payment Transaction

***Could be:***

➤ Either In-house

Payer – Bank + Payee

➤ Or Interbank

Payer – Payer's Bank   Payee's Bank + Payee

↑  
Interbank Clearing and  
Settlement Domain

## Interbank Clearing and Settlement – I

## Settlement

1. Bilateral – in a correspondent account



2. Over a series of bilateral settlements in correspondent accounts



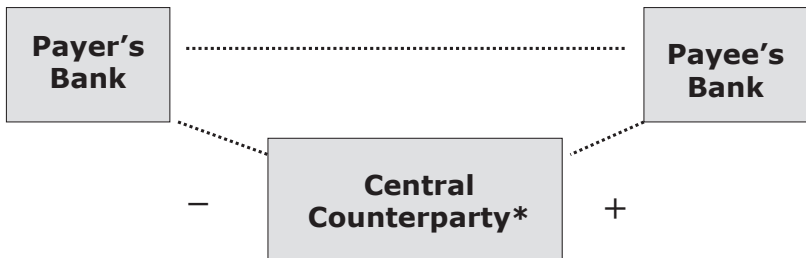
## Notes

\* Including the central bank

- ..... Interbank communication

## Interbank Clearing and Settlement – II

3. Over the books of a central counterparty\* on either bilateral or multilateral basis (usually in the context of multibank payment system)

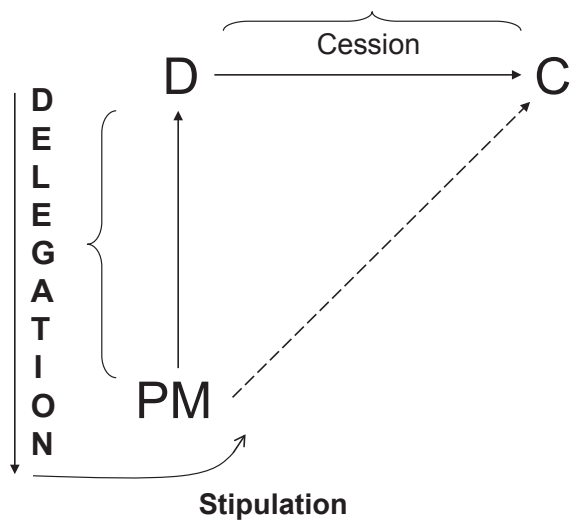


### Notes

\* Including the central bank

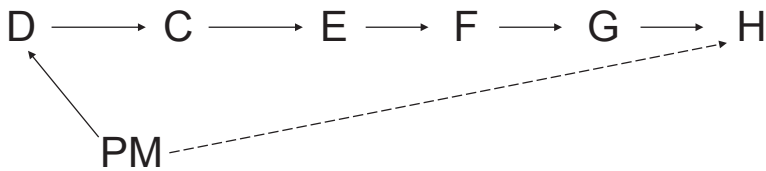
..... Interbank communication

Delegation and Cession  
in Roman Law [chapter five]



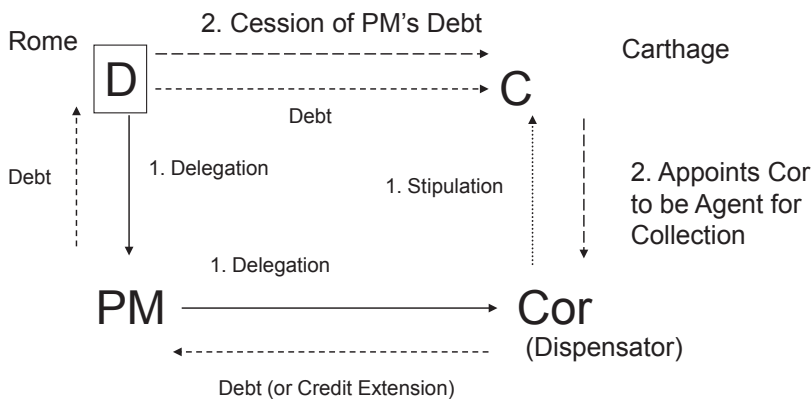
Circulation of Credit  
in Ancient Rome [chapter five]

By means of either redelegation or  
re-cession series





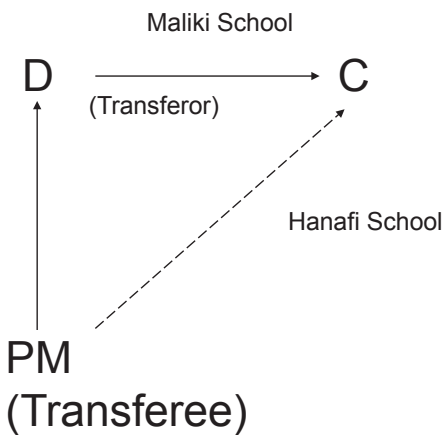
Roman Law in Practice:  
Payment to a Distant Party [chapter five]



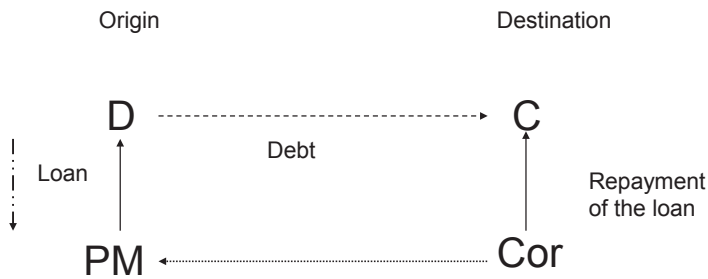
Discharge

1. Stipulation by Cor to C (in Carthage)
2. At the time of D's cession (in Rome)

Parties to Islamic *Hawale* [chapter six]



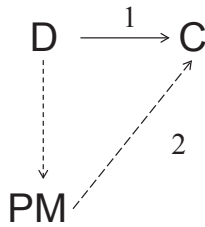
Islamic *Suftaj*: C v Cor  
by Means of two *Hawales* [chapter six (and  
seven)]  
[in second *hawale* – PM is debtor and Cor is  
paymaster]



**Hanafi:** PM/C; Cor/C;  
by means of *suftaj* document sent by D to C – **and C's presentment to Cor.**

**Maliki:** D/C; PM/C;  
by means of *suftaj* document sent by D to C – **alone.**

## Talmudic 'Unilateral' Deposit-transfers [chapter seven]

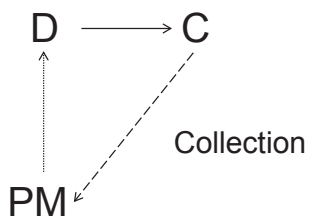


Transfer of claim to Deposit held by PM (custodian) from  
depositor D to his creditor C by:

- 1. *Oditta*** – D's own formal acknowledgement; or
- 2. *Zechi*** – proprietary act of PM: [at D's instruction].

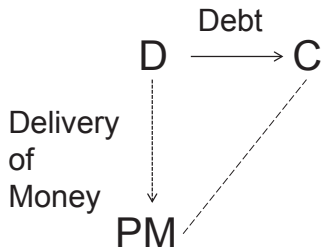
The Talmudic ***Urcheta*** [chapter seven]

***Urcheta***



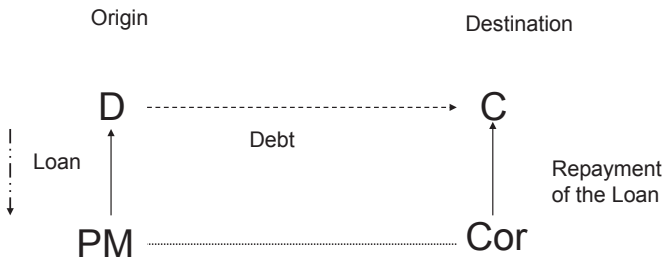
1. D: [C's debtor and PM's creditor] — ***Urcheta*** issuer
2. C: Emissary with authority to collect from PM [PM's debt to D with the view of applying the proceeds to D's debt to him]
3. PM: D's debtor

The Talmudic ***Dyokani*** [chapter seven]



PM – C’s emissary to whom D entrusted the money in discharge of D’s debt to C – ***Is PM C’s agent?***

Talmudic *Dyokani* Turns *Suftaj* [chapter seven]  
*[May Shimon go after Reuven?]*



**D:** either *Reuven* (in scenario #1) or *unknown debtor of Shimon* (in scenario #2)

**C:** *Shimon* (in both scenarios)

**PM:** either *Levy* (in scenario #1) or *Reuven* (in scenario #2)

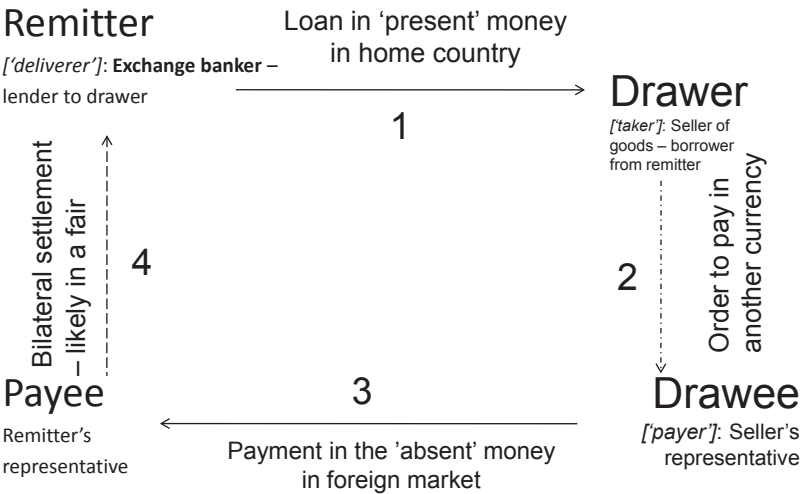
**Cor:** *Levy* (in both scenarios)



Parties to the Four-party Medieval Bill of Payment in  
the Continent – ‘Export [trade] Bill’ [chapter  
eight]

- **Remitter** [*‘deliverer’*]: **Exchange banker** – lender to drawer in home country;
- **Drawer** [*‘taker’*]: seller of goods – borrower from remitter in home country to procure goods;
- **Drawee** [*‘payer’*]: seller’s agent, partner, or correspondent [or in theory, even buyer] in the foreign market who was to be paid by his own buyers;
- **Payee**: remitter’s agent partner, or correspondent in foreign market

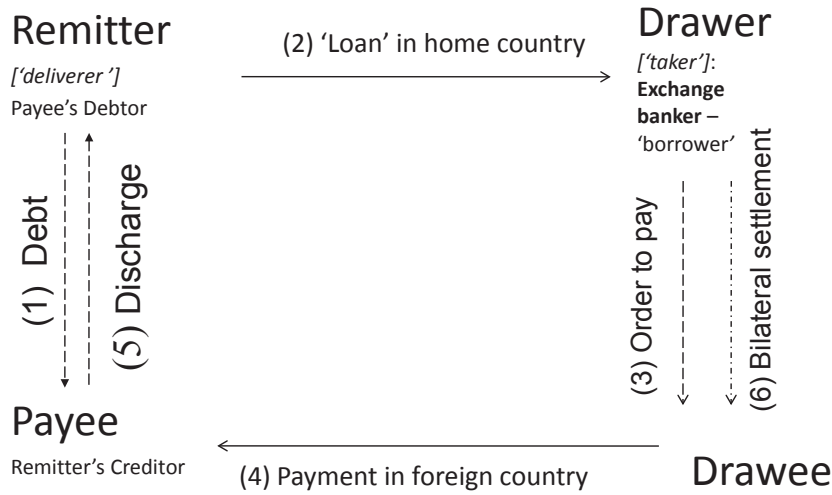
Four-party Medieval Bill of Payment in the Continent –  
‘Export [trade] Bill’ [chapter eight]



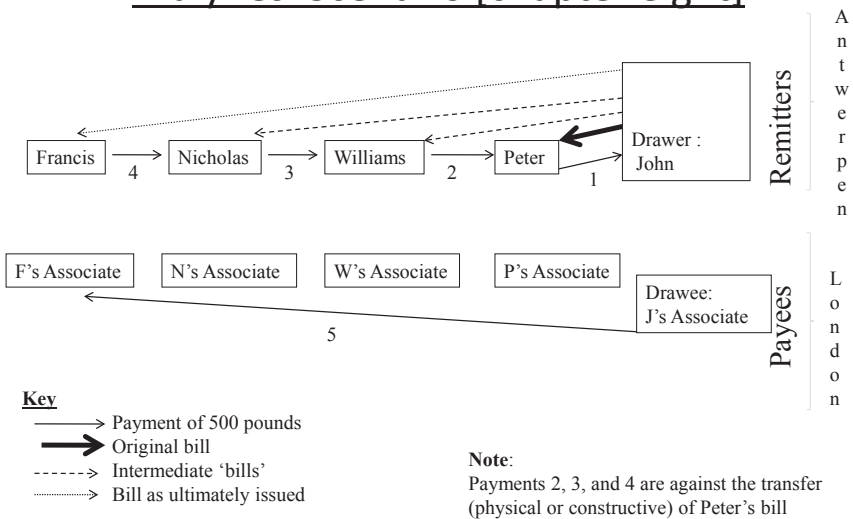
Four-party Medieval Bill of Payment in the  
Continent – Remittance Bill [chapter eight]

- **Remitter** [*'deliverer'*]: – debtor in home country to payee in foreign country – 'lender' to local exchange banker;
- **Drawer** [*'taker'*]: **Exchange banker** – 'borrower' from remitter in home country;
- **Drawee** [*'payer'*]: remitter's agent, partner, or correspondent in the foreign country;
- **Payee**: remitter's creditor in foreign country – to be paid by drawee

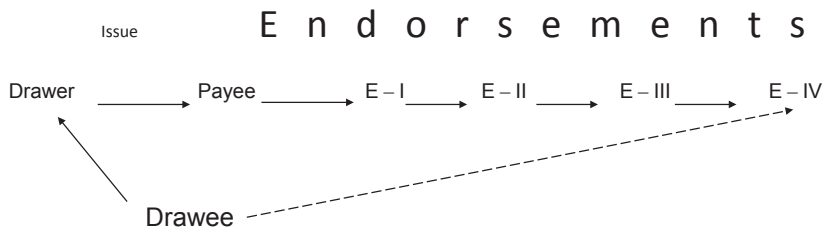
Four-party Medieval Bill of Payment in the  
Continent – Remittance Bill [chapter eight]



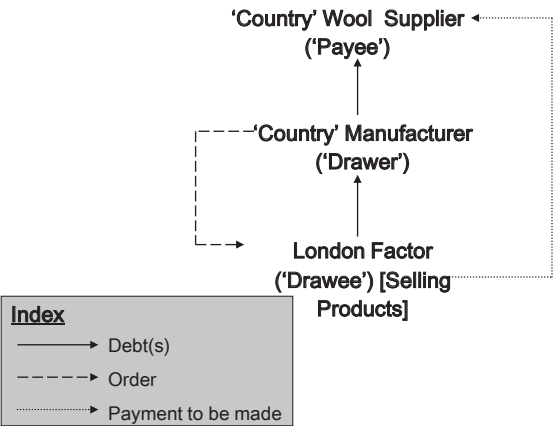
Bills ‘Put Over’ before They are Made:  
Malynes’ Scenario [chapter eight]



Bill Discounting [chapters eight–eleven]

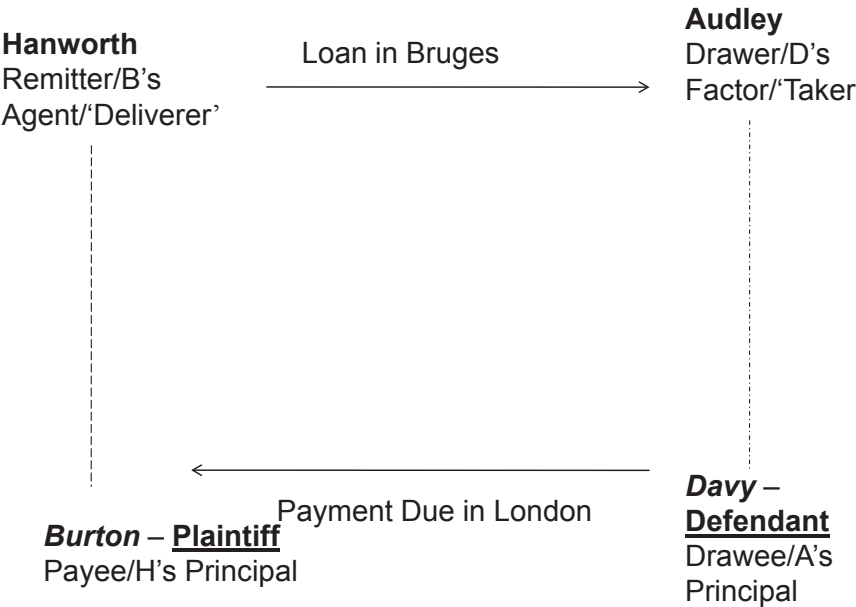


A Seventeenth-Century Inland Bill of Exchange  
in England [chapters eight and nine]

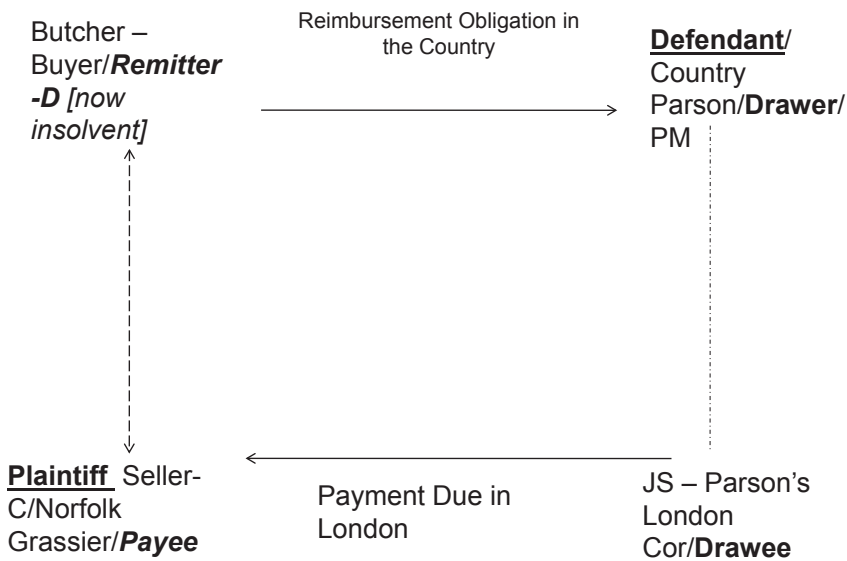




Burton v Davy [chapters nine and eleven]



Chat and Edgar Case [chapters nine and eleven]



## Discountable Bill/Trade Acceptance in International Trade [chapter ten]

***To: Importer/Buyer (–)  
Pay to Exporter/Seller  
(–) Exporter/Seller***

- Once accepted it becomes a 'trade acceptance' on which buyer-acceptor incurs liability similar to that of a maker of a note:

***I (Buyer) promise to  
pay Seller  
(–) Buyer***

**BUT:** Unaccepted (yet 'drawn') bill (and not unsigned note) can be 'discounted' by Exporter/Seller with his bank for its present value prior to its dispatch to the buyer for acceptance

**Key:** (–) Signature

## Model Central Bank Balance Sheet [chapter ten]

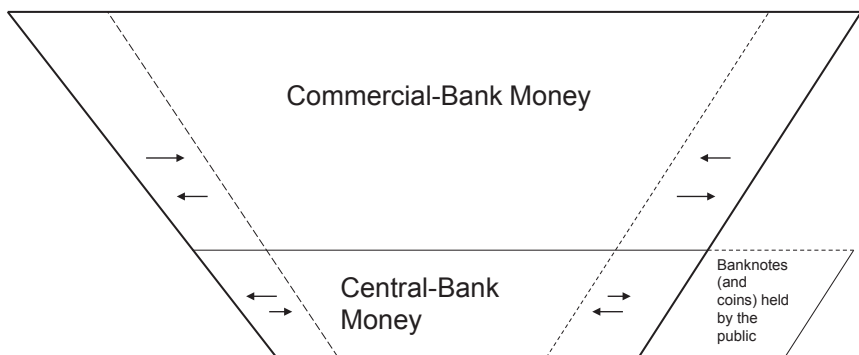
### Assets

- Precious metals
- Liquid foreign reserves
- ***Domestic government debt securities***
- Loans to commercial banks
- Loans to the government

### Liabilities

- ***Deposits held by commercial banks*** (in reserve or settlement accounts)
- Government deposits
- Banknotes (currency) held by the public

## Regulation of Money Supply [chapter ten]



### Notes

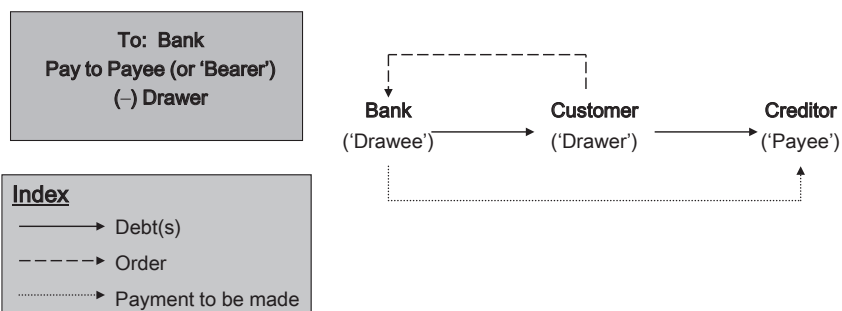
- 1) Amount of commercial-bank money **increases** with the **increase** in the amount of central-bank money
- 2) Amount of commercial-bank money **decreases** with the **decrease** in the amount of central-bank money

### Definitions

- 1) **Monetary base** = central-bank money + banknotes (and coins) held by the public
- 2) **Money supply** = commercial-bank money + banknotes (and coins) held by the public

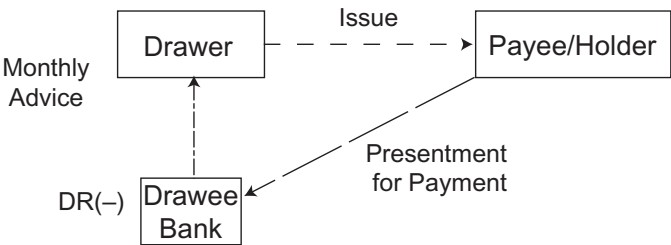
# Cheque in a Setting

- Order of a customer to his or her bank to pay to the customer’s creditor

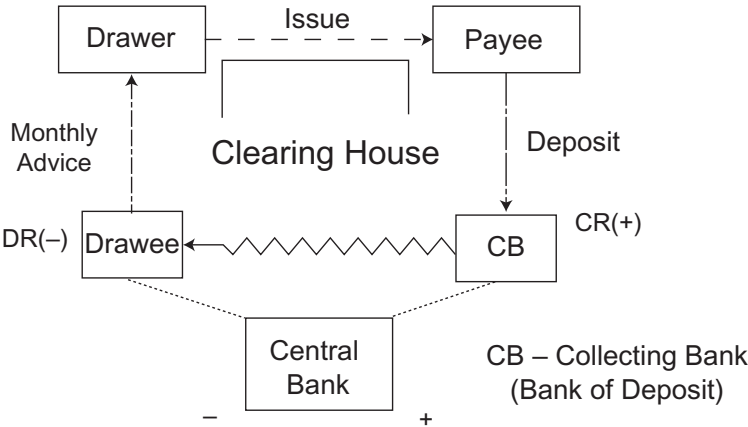


# Payment and Collection of Cheques – I

## Payment of a Cheque Over the Counter

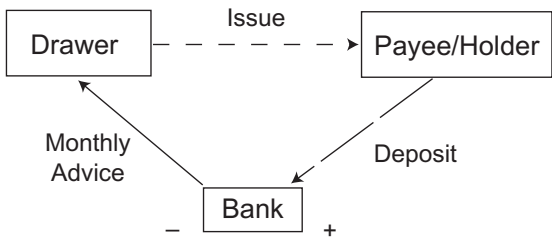


## Collection of Cheques

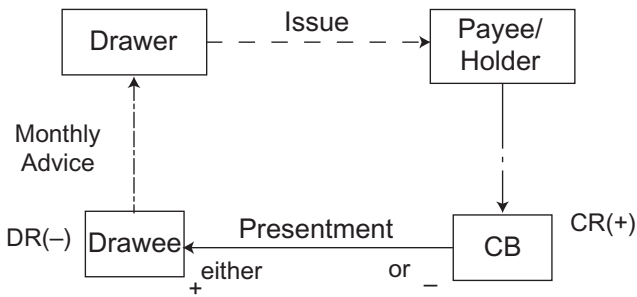


# Payment and Collection of Cheques – II

## Payment of an 'On Us' Cheque



## Collection of Cheques Drawn on and Deposited to a Correspondent



CB – Collecting Bank



## Negotiable Instruments – Principal Features [chapter eleven]

- **Bill** – drawer's **order** to drawee
  - **Note** – maker's **promise**
  - **Cheque** – drawer's **order** to drawee-banker
- 

Signed unconditional –

- (i) Order [for bill or cheque] or
- (ii) Promise [for note]

in writing – to pay a sum certain in money

---

- Cheques must be payable on demand;
  - Bills and notes fall into two groups: either payable on demand; or payable at a fixed or determinable future time
- 

### Two categories for bills, notes, and cheques

- Instruments payable to **order** [of named payee – transferable by delivery and endorsement]
- Instruments payable to **bearer** [transferable by delivery]

## Negotiability [chapter eleven]

### Procedural

Transferability by physical delivery – *plus endorsement for instrument payable to order* – so as to give transferee-holder right to sue in own name and give discharge.

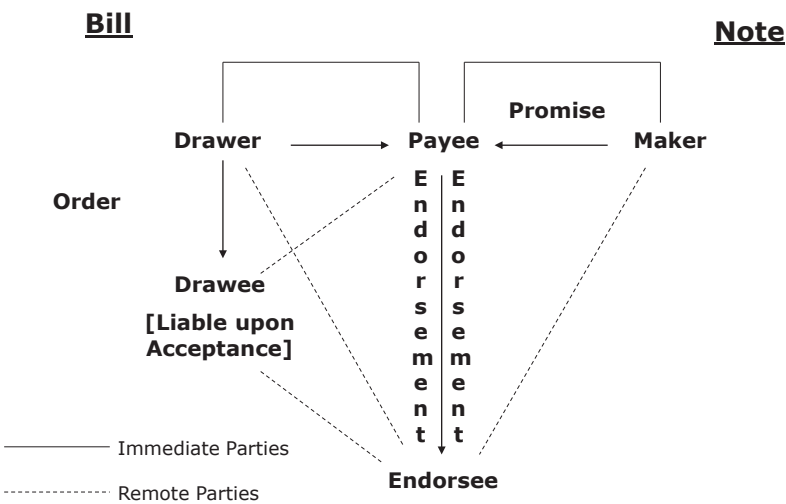
### Material

Freedom from most:

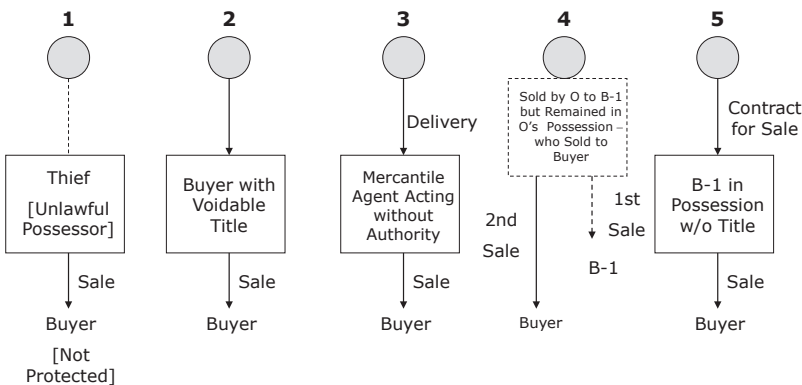
- Adverse [property] ***claims***; and
- Prior party's contract ***defences***

-----  
Available only to  
[transferee-]holder taking  
in good faith and for  
value.

Parties to Negotiable Instrument Payable  
to Order [chapter eleven]

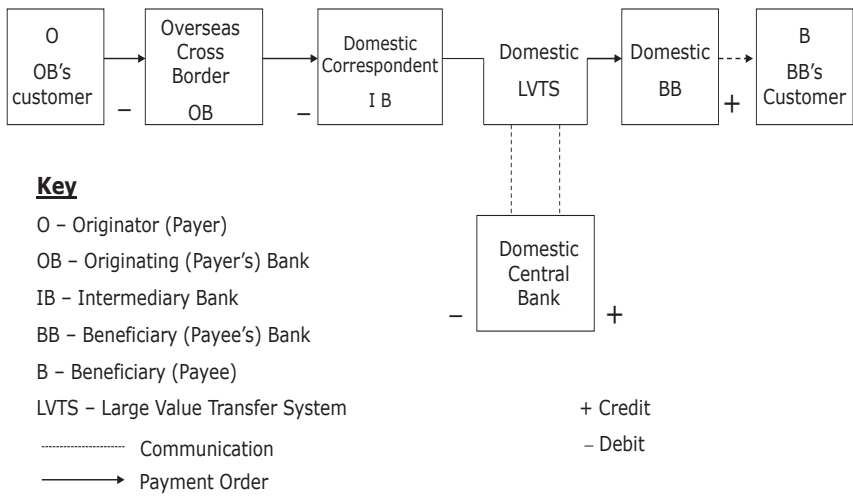


Statutory Protection to Buyer of Goods from  
Lawful Possessor w/o Title [chapter eleven]



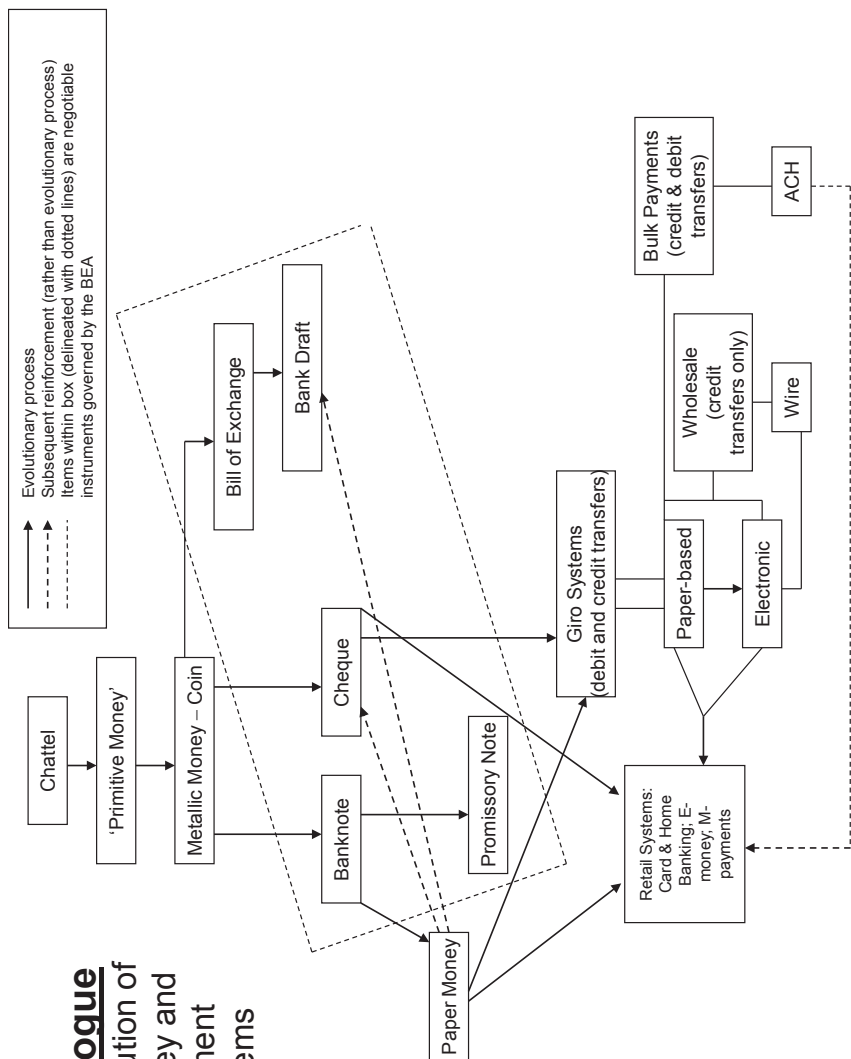
**Buyer – if Bona Fide – is Protected in scenarios 2–5 but not 1.**

A Typical Itinerary for Incoming Cross-border Wire-transfer in Domestic Currency  
[chapter twelve]



# Epilogue

## Evolution of Money and Payment Systems





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# Index

*A/S Awilco v Fulvia SPA di Navigazione (The Chikuma)* (1981) 59, 623

Abayee 102, 105, 106

*Abingdon v Martin* (1293) 542

Abraham 19, 75, 94

access card 65–6

*see also* payment cards

Account *see* bailment of money

*aes grave* 83

*Afovos Shipping Co SA v Pagnan, The Afovos* [1982] 28

*Ag Alta v AG Can* [1939] 26

*agio* 366

*Agricultural Credit Corp of Saskatchewan v Pettyjohn* [1991] 559

*Alan, WJ & Co Ltd v El Nasr Export & Import Co* (1972) 55, 185, 626

Albeck, S 162, 163

Alexander the Great 84, 125, 132, 140

*Alexander v Brown* (1824) 27

Ameimar 322, 324, 332, 333, 334, 337, 338

Ames, JB 436, 571

Amsterdam Exchange Bank 483

Ancient Egypt

barter 74, 75, 140

medium of exchange 140

*see also* Greco–Roman Egypt

Ancient Greece 8

banking 124–32, 155–6

*chirograph* 129, 231, 279, 304, 317, 570, 582

classical period 124

coins 76, 82, 86–7, 125

*demisiai trapezai* 126, 146

deposit banking 125, 126–32, 484

deposit payable on demand 128

*diagraphé* 129, 130, 131

discharge of debts 131

funds transfers 117, 124–32, 155–6

*hypographé* 130, 131

intercity payments 131–2

monetary unions 84

non-cash payments 128–9

payment orders 128–31

private banks 126–7

public banks 126

small change 125

*syngraph* 129, 231, 279, 304, 318, 570, 582

temple banks 125, 142

*trapeza* 126, 127, 128–32

*trapezitai* (moneychangers) 125–31, 133, 134, 155, 588

Ancient Mesopotamia 8

assignment of debt 122–4

banking services 119–24, 155

bearer clause 123, 124, 282

bill of exchange 122

Code of Hammurabi 20, 76, 121

coins 79

deposit banking 120–4

Fertile Crescent 118

funds transfers 117, 118–24, 155

grain as medium of exchange 76, 120, 121, 282

granaries 120–1, 122, 309, 597

*kârum* 120

Laws of Eshnunna 121

loans 121

money 20, 76, 119–20

payment orders 121–2

primitive money 120

Ancient Persia 76, 82, 84, 85, 86

Ancient Rome 76

*aes grave* 83

*argentarii* 134, 135, 136–7, 138, 588

auctions 134, 135–7, 139, 156, 220, 588

stipulation 216–17

banking 117, 132–9, 155–6, 353

*coactores* 135, 136, 137, 138, 144, 588

*coactores argentarii* 135, 137, 144

coins 82–3, 86–7, 133

deposit banking 137–8

fall 87, 352

funds transfers 117, 132–9, 155–6

interbank payments 138

metallic money 87

non-cash payments 133, 138

*nummularii* 134–5, 137, 138

*praeco* 136

*rationes* 138

temple banks 133–4

*see also* Roman law

Andreau, J 125, 133, 134

*Anglo-Italian Bank v Wells* (1878) 573

*Anon* (1573) 428

*Anon* (1668) 455, 456

*Anon* (1694) 451, 452, 531

*Anon* (1696) 452

*Anon* (1697) 575

- Anon* (1699) 555, 556, 560  
*Anon* [1701] 478, 631  
*Anon* (1701) 631  
*Anonymous case* (1368) 426, 431, 439, 440–1, 453–4  
*Anonymous case* (1479) 436  
*Anonymous case* (1505) 431  
*Anonymous case* (1506) 436, 439  
 Antiochus VII, Ruler of Seleucid Empire 86  
 Antoninus Pius, Emperor 236  
 Antwerp 375  
*ANZ Banking Group Ltd v Westpac Banking Corp* (1988) 29  
 APACS 497  
*argentarii* 134, 135, 136–7, 138, 588  
*argyropates* 144  
 Aristotle 17, 19, 78, 520  
 Arnold, MS 435  
 Ashi, Rav 322, 324–5, 332–3, 334, 337, 338  
 assignment of debt 525, 635  
     Ancient Mesopotamia 122–4  
     bailment of money and 425, 434, 461–2, 464  
     bill of exchange 531–2  
     *cessio/cession* *see* Roman law  
     English common law 424–5, 464, 465  
     equity and 540–1  
     funds transfer and 607–8  
     paymaster's obligation and 634–5  
     Roman law 238–41  
 Association for Payment Clearing and Services (APACS) 497  
*Assumpsit* 446–8, 449, 462, 464  
     *Indebitatus Assumpsit* 438, 452–3, 454, 455, 456, 462, 465, 536  
     tender of bad money 31  
 Assyria 75, 79, 84, 119, 120  
*Atwood v Cornwall* (1873) 30, 31  
 Auctions  
     Ancient Rome 134, 135–7, 139, 156, 220, 588  
     stipulation 216–17  
     Greco–Roman Egypt 144  
 Avignon 375  
*Ayres v Moore* [1940] 460, 580  
  
 Baal Ha-Itur (Rabbi Yitzchak ben Rabbi Abba Mari) 186, 339, 340, 351  
 Babylonia 20, 75, 84, 119, 120, 122, 282  
     promissory note 317  
     Talmud and 6, 7, 13, 158, 303, 306, 342  
 Bach (Rabbi Yoel ben Shmuel Sirkes) 187, 325  
 Bagehot, W 499  
 Bagnall, RS 150  
 bailment of money 9, 36, 424, 425–33  
     Account  
         bailor–bailee relationship 426–33, 454  
         beneficiary's right to bailed funds 434–41  
     assignment of debt and 425, 434, 461–2, 464  
     banking and 430  
     beneficiary's right to bailed funds 433–42  
         privity 42, 439–40, 454, 456, 462, 464, 465  
     bill of exchange compared 453–64  
     conditional discharge 455–7  
     conditional payment principle 455–6  
     countermandable bailment 441, 454–5, 457  
     Debt 600  
         Bailor–bailee relationship 426–33, 454  
         beneficiary's right to bailed funds 434–42, 455  
     Detinue  
         Bailor–bailee relationship 426–33  
         beneficiary's right to bailed funds 437, 440  
     failure of purpose 426  
     *force majeure* defence 429  
     *Indebitatus Assumpsit* 438, 442  
     meaning 426  
     money sealed in a bag etc 426, 428–9  
     Roman law and 432–3, 465, 596–7  
     safekeeping, for 427–8, 430, 431  
         delivery to third party–beneficiary 430, 432  
         specific chattel 432–3  
     Talmud and 432–3, 597  
     *zech* compared 464–5  
 Baker, JH 448, 451  
*Baker v Lambert and Grelle v Lambert* (1510–13) 459, 568–9  
*Balmoral Supermarket Ltd v Bank of New Zealand* (1974) 35–7  
*Banco de Portugal v Waterlow and Sons, Ltd* 509, 511–14, 516, 517, 519, 563  
 banco florin 366, 367  
 Bank of Amsterdam 369, 550  
     bank charges 367  
     bill of exchange 367  
     cash withdrawals 368  
     cashiers 367, 368  
     daily settlement 367  
     decline 368  
     deposit and transfer banking 364, 366–7  
     loans 368  
     receipt for deposit 367  
*Bank of Canada Act* 510  
*Bank of Canada v Bank of Montreal* (1977) 506, 509, 510, 511, 514–17, 522  
*Bank Charter Act, 1844* 489–90, 491  
 bank deposit 596–604  
     consolidator, payment to 603  
     irregular deposit *see* irregular deposit  
     payment aggregator, payment to 603  
     payment institution, payment to 603  
     pre-paid card 602  
     Roman law 596–7, 600  
     smart cards 602  
     stored-value product (SVP) 602, 603  
     Talmud 597  
 Bank of England 9, 485–7

- bank rate 500–1
- as central bank 497–505
- central-bank money 493–4, 501, 502, 504–5, 523–7
- establishment 21, 485
- funds held on deposit 502
- gold standard 491–2
- interbank clearing and settlement 492–7, 498
- as lender of last resort 498, 504
- loans 500, 502
- monetary policy 497–505
- nationalization 505
- notes 22, 367, 487–92, 499, 518
  - as promissory notes 533
- open-market operations 501–4
- price stability 504
- reserves or settlement balances 503
- as settlement bank 492–7
- see also* central bank
- Bank of England Act, 1833* 489, 491
- Bank of England Act, 1946* 505
- Bank of England v Anderson* (1837) 488
- Bank of England v Newman* (1700) 479, 632
- bank failures 4
- bank money 25, 523, 622
  - central-bank money 493–4, 501, 502, 504–5, 523–4, 676
  - commercial-bank money 25, 500, 502, 523–7, 596, 676
  - currency 561–2, 563–4
  - earmark, lack of 562
  - England 468–9
  - Medieval Continental Europe 361, 365, 366, 367, 369
  - monetary value 523–7
  - origins 69
  - verification 563–4
- Bank Notes (Scotland) Act, 1845* (UK) 490
- Bank of Nova Scotia v Wu* (unreported) 29
- bank rate 500–1
- Bank of Sweden 368–9, 472
- Bank of US v Bank of Georgia* (1825) 31
- Banker
  - definition 43
  - history of term 358
- banker's instrument
  - enforcement of paymaster's obligation 63–4
- banking 3, 116
  - Ancient Greece 124–32, 155
  - Ancient Mesopotamia 119–24
  - Ancient Rome 117, 132–9, 155–6, 353
  - Greco-Roman Egypt 117, 140–55, 156–7
  - Medieval Continental Europe 352–7, 418–19
- banknotes 2, 3, 16, 18, 21–3, 25, 91, 519, 521–3
  - as abstract obligations 22
  - Bank of England notes 22, 367, 487–92, 499, 518, 533
  - Canada 506, 509–10, 522
  - central bank and 4
  - convertibility 22
  - counterfeit 561, 563
  - credit currency 519
  - emergence 21, 115
  - England 468, 469, 470–81
    - as 'fiat money' 21
  - goldsmith's notes *see* goldsmith bank system
  - issue 22, 23–4
  - issuer's obligation to pay 22
  - metallism and 521
  - nature 21
  - Northern Ireland 490
  - obligation to pay in specie 22
  - payment in 25–6
    - as payment mechanism 521–2
  - as promissory notes 507–18, 533
  - Scotland 490
  - as tokens 22
  - transportation and 38–9, 41, 42, 43, 44, 45, 46, 60
  - units of account 21–2
  - value 21
  - see also* paper money
- banks
  - meaning 3, 24
- Banks v Colwell* (1788) 577
- Banque Belge Pour L'Etranger v Hambrouck* [1921] 54
- Barcelona 363, 375
- Barclays Bank v Bank of England* [1985] 612
- Barclays Bank v Price Waterhouse* (2000) 55
- Barclays Bank v WJ Simms Son & Cooke (Southern)* [1980] 186, 613, 618
- barley *see* grain
- Barnaby v Rigalt* (1635) 449, 458
- barter 2, 17, 19, 73, 77
  - Ancient Egypt 74, 75, 140
  - cambium* 372
  - caravan trade 76–7
  - chalifin* 97–8, 110, 303, 313, 314, 317
  - kinyan sudar* 98, 313, 314
  - drawbacks 74–5
  - Hebrew Bible 75, 76
  - international trade 76
  - permutatio* 372, 373, 375, 393
  - Talmud 97–8, 110, 303, 313, 314, 317
- Bartolo Da Sassiferrato 362
- basilicon* 146
- basilikai trapezai* 145–7, 152
- bearer clause
  - Ancient Mesopotamia 123, 124, 282
  - Continental bill of exchange 415
  - English common law 444–5, 449
  - meaning 542–7
  - Medieval *hawale* 303

- bearer clause (*cont.*):
  - as power of attorney 444
  - Talmud 320
  - see also* instruments payable to the bearer
- Beaulieu v Finglam* (1401) 450
- Beckingham and Lambert v Vaughan* (1616) 454
- Beutel, FK 443, 568–9
- Bible *see* Hebrew Bible
- bill discounting 670
  - bill of exchange 468, 529
  - goldsmith bank system 472, 474–5
- bill of exchange 9, 10, 11, 41
  - Ancient Mesopotamia 122
  - assignment of debt 531–2
  - Assumpsit* 446–8, 449, 462, 464
  - Indebitatus Assumpsit* 438, 452–3, 454, 455, 456, 462, 465, 536
  - autonomy of obligation 416–18
  - bailment of money compared 453–64
  - conditional payment principle 458
  - Continental bill of exchange 117, 290, 401–18, 420
    - bearer clause 415
    - endorsement 401–18
    - la provision* 417, 461–2, 607
  - discounting 468, 529
- endorsement 370, 471, 534, 553, 606
  - autonomy of obligation 416–18
  - bill with payee in blank 403, 405, 406
  - book transfer outside banks and 403, 407–9, 413
  - cessio* and 414–17
  - drawee's consent to transfer 413
  - effect 411
  - history 377, 401–15
  - la provision* and 417
  - nature 414–15
  - negotiability and 401–2
  - novatio* and 414–17
  - scope of holder's entitlement 416–18
  - strict privity and 405, 407
  - transfer of bill before making 403–6, 669
- English common law 442–53
  - history 370–1
  - holder in due course doctrine 459–60
  - law merchant and 9, 424, 443, 444, 445, 449, 450–3, 530
    - custom and 444, 445, 449, 450
  - mandate 613
- Medieval Continental Europe 290, 357, 362, 365, 401–8, 484
  - Bank of Amsterdam 367
- Medieval *hawale* and 301–6, 420–2, 464
  - suftaj* 303–6, 421
- nature 370, 606
- negotiability 370, 569
- negotiation 370, 529, 606
  - operation 370
  - origins 117
  - Roman law and 117, 251, 418
  - Scotland 607
  - signature 387, 388, 607
  - la provision* and 387
  - Talmud and 319, 351
  - zech* compared 464–5
  - transfer 370
- bill or letter of payment *see* Medieval Continental Europe
- bill payable to order
  - endorsement 370, 387, 413–14, 415, 607
  - negotiation 530, 531–3
- billon 89, 382
- Bills of Exchange Act*, 1882 (UK) 370, 452, 508–9, 537, 541, 547, 548, 552, 567, 578, 580, 583, 606
- Bills of Exchange Act* (Canada) 509–11, 514–18
- Bishop v Viscountess Montague* (1601) 558
- black money 89, 382
- Black v Smith* (1791) 27
- Blackstone, William 113
- Blyth Shipbuilding and Dry Docks Co Ltd, In Re* [1926] 32
- BNS v Angelica Whitewear* (1987) 63
- Boehm v Sterling* (1797) 547–8, 577
- Bogaert, R 354
  - Ancient Greece 124–32 *passim*
  - Ancient Mesopotamia 118–24 *passim*, 282, 309
  - Greco-Roman Egypt 140–55 *passim*, 156
  - cheques 150–3
- Bologna 375
- bonae fidei* contract 194, 196, 202, 213, 226
- Boyer–Xambeu, MT 371, 375, 376, 377, 380, 381, 382
- Brady v Jones* (1823) 27
- brassage 71
- Bretton v Barnet* [1599] 24, 598
- Bretton v Barnet* (1599) 429, 431, 453, 597–8
- Brimmes Tenax Steamship Co Ltd v The Brimmes (Owners)* [1973] 59, 186, 524, 622, 623
- British Linen Co v Hay & Robertson and Brown* (1885) 240, 635
- Broken Hill Proprietary Company, Ltd v Latham* [1933] 520
- Brooke, R 437
- Brown, EH 505
- Brown v Davies* (1789) 577
- Brown v London* (1670) 449, 454, 455, 456, 458, 537
- Brown v Marsh* (1721) 535
- Browne v London* (1670) 537
- Bruges
  - bills of exchange 442–5
  - Medieval fairs 375

- Brun St Mitchel v Troner* (1275) 542  
*Buller v Crips* (1703) 537–40  
 Burns, AR 77, 78, 79, 83, 122  
*Burton v Davy* (1437) 442–5, 449, 459, 460, 543, 569, 672
- Cairo *Geniza* 277  
   meaning of ‘Geniza’ 277  
   *ruq’a* and *sakk* instruments 281  
*Calico Printers’ Association Ltd v Barclays Bank Ltd* (1930) 620  
*cambium* contract *see* Medieval Continental Europe
- Campania 83
- Canada  
   Bank of Canada 510  
   banknotes 506, 509–10, 522  
   bill of exchange 509–10  
   *Bills of Exchange Act* 509–11, 514–18  
   paper money 506  
   Quebec Civil Code  
     mandate 617–18  
     paymaster’s obligation 637  
*Capital Associates Ltd v Royal Bank of Canada* (1970) 153
- Cappadocia 75, 79
- Caradoc Nurseries Ltd v Marsh* (1959) 32
- caravan trade 376  
   primitive money 76–7
- Carlos v Fancourt* (1794) 533, 541, 569
- Carolingian Empire  
   coins 88  
   collapse 89  
   payments in kind 87
- Carthaginians 76
- Case de Mixt Moneys* 88, 114–15, 518, 521
- Case of the Marshalsea, The* (1455) 429
- central bank 4, 5, 18, 21, 23–4, 468  
   bank rate 500–1  
   defining 24  
   foreign currency and 4–5, 23  
   functions 4, 484, 486–7  
   funds held on deposit 502  
   inflation and 499  
   issue of banknotes 22–3  
   as lender of last resort 484, 498, 503  
   model balance sheet 675  
   monetary policy 497–505  
   national/official currency 3  
   open market operations 501–4  
   price stability 504  
   reserves or settlement balances 503  
   role 23–4  
   *see also* Bank of England
- cessio/cession see* Roman law
- Chafee, Z 572, 573
- Chaldea 122
- Chambers v Miller* (1862) 33–5, 36–7
- Champagne  
   Medieval fairs 375, 377
- CHAPS system 497
- Charge Card Services Ltd, Re* (1988) 55, 65, 66, 625, 626
- Charlemagne 87, 88
- Charles I, King of England 474, 485
- Charles II, King of England 485, 487
- Chat and Edgar Case* (1663) 447–8, 451, 532, 673
- cheque collection 41, 46, 58, 149, 153, 363, 678, 679  
   Greco–Roman Egypt 153–4  
   as mandate 612
- cheque guarantee card 64
- cheques 10, 24, 41, 468, 649  
   enforcement of paymaster’s obligation 61, 62, 63
- England 470–1  
   goldsmith bank system 471–7, 481–2  
   *Vyner v Clipsham* 482
- Greco–Roman Egypt 8, 149–55, 157, 159, 471, 484
- law merchant 547
- mandate 612, 618–19
- Medieval Continental Europe 363–4, 365, 368, 549–50  
   Amsterdam 550  
   Italy 659
- Medieval *hawale* and 278
- nature 62, 547
- negotiation 530, 547–52
- payment 62, 678, 679  
   as setting 677
- Talmud law *see* Talmud
- Cheshire & Co v Vaughan Bros & Co* [1920] 620
- Chicago  
   grain banking 141
- Child Report 497
- China  
   paper money 471–2, 484, 506
- chirograph* 129, 231, 279, 304, 317, 570, 582
- Chisda–Rabbah, Rav 326, 328
- circulation of credit  
   Roman law 242–3, 302–3, 306, 532–3, 657
- Clark’s Case* (1614) 438
- Clarysse, W 140
- Claxton v Swift* (1685) 451, 531
- clearing houses/facilities 4, 9, 24
- Clerk v Mundall* (1698) 632
- Clerk v Mundall* (1700) 479
- Clerke v Martin* (1702) 534–7, 539–40, 545
- coactores* 135, 136, 137, 138, 144, 588
- coactores argentarii* 135, 137, 144
- Code of Hammurabi 20, 76, 121

- Coggs v Bernard* (1703) 310, 430  
 coins 2, 3, 16, 21–3, 25  
   as abstract obligations 22  
   Antiquity and the Middle Ages 68–72, 92, 523  
     *aes grave* 83  
     Ancient Greece 76, 82, 86–7, 125  
     Ancient Mesopotamia 79  
     Ancient Rome 82–3, 86–7, 133  
     Anglo-Saxon money 88  
     bank money 69  
     black money/billon 89  
     brassage 71  
     Britain 88  
     Carolingian Empire 88  
     Carthaginians 76  
     commodity value 82  
     copper *see* copper  
     debasement 72, 89, 90–1  
     denominations 69–70, 71  
     electrum 80, 81, 82  
     expansion 81–7  
     gold *see* gold  
     government seal 89  
     gross seigniorage 71, 72  
     ingots 75, 79, 80, 82  
     inscriptions 85  
     international trade 83–4  
     large-value coins 71, 72  
     liquidity service 71  
     Lydia 79–81, 82, 84, 85  
     marks 82, 87  
     metallic money 77–81, 82, 518  
     minting 70, 71, 82, 90  
     monetary unions 84  
     net seigniorage 71, 90, 113  
     origins 73–81  
     penny 88–9, 112  
     private coinage 84–5  
     production costs 71  
     punch marks 79, 80, 81  
     purchasing power 69, 70, 72, 75  
     re-coinages 90–1  
     Roman law 111–15  
     rulers' effigy 85–6, 92  
     seigniorage 71  
     silver *see* silver  
     size 69–70  
     small change 72, 89–90  
     small-value coins 71–2, 83  
     stamping 69, 83  
     State coinage 84  
     sterling 88  
     Talmud *see* Talmud  
     tokens 72  
     transformation 89–91  
     units of account 69  
     value of metal 70–1  
       weight 69, 78, 79, 80, 81, 82  
     central bank and 4  
     copper *see* copper  
     counterfeit 43, 82, 126, 144, 365, 380  
     debasement 72, 89, 90–1, 113, 523  
     demonitized 103, 105, 106–7, 109, 112  
     earmark, lack of 557–8  
     emergence 21  
     gold *see* gold  
     international trade 83–4  
     issue 22  
     issuer's obligation to pay 22  
     Medieval Continental Europe 361, 365, 366, 367  
     metallism 68–9, 71, 73  
     nature 21  
     nominalism 68, 69, 71  
     obligation to pay in specie 22  
     payment in 25–6  
     penny 87–9, 112  
     re-coinages 90–1  
     Roman law 111–15  
     scarcity 3, 38  
     shilling 88  
     silver *see* silver  
     sixteenth and seventeenth centuries 91  
     small change 18, 24, 72, 89–90  
     sterling 88, 113–14  
     Talmud *see* Talmud  
     as tokens 21, 22, 72, 73  
     transportation and 38–9, 41, 42, 43, 44, 45, 46, 60  
     units of account 19, 21–2, 69  
     value 21  
     weight units and 19, 21  
     *see also* metallic money
- Coke, E 28  
*collectarios* 144  
*Colonial Bank of Australasia v Marshall* [1906] 618  
*Colonial Bank v Cady* (1890) 565  
 Commercial-bank money 25, 500, 502, 523–7, 596, 676  
   *see also* bank money  
 commodities  
   as medium of exchange 19, 20, 32, 75, 76, 77, 78, 120, 121, 122  
   *see also* copper; gold; grain; silver  
 common law of England *see* English common law  
 communist societies 17  
*Comptroller of Stamps (Victoria) v Howard-Smith* (1936) 50  
 conditional payment principle  
   bailment of money 455–6  
   bill of exchange 458  
   English law 625–6  
   Germany 625

- goldsmith's note 478–81, 630–2
- Medieval bill of payment 388
- paymaster's obligation and 625–6, 632–4
- Talmud and 351
- United States 480, 632–4
- Constantine Emilianides v Aristodemo Sophocli* (1910) 257
- constitutum debiti alieni* 210, 211–14, 229, 230, 232
  - Medieval bill of payment and 389–90, 391
  - Paymaster's obligation 629
- Continental bill of exchange *see* bill of exchange
- Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes (Geneva Bills Convention) 160, 370, 387, 417, 507–8, 551, 606–7
  - holder in due course doctrine and 580
- Conversion 546, 558
- Cooksey v Boverie* (1693) 477
- Copper
  - coins 99, 100, 472
    - black money/billon 89, 382
  - Greco–Roman Egypt 140, 144, 148, 150
    - as medium of exchange 74, 75, 82, 83, 122, 140
- Corbit v Bank of Smyrna* (1837) 480, 632
- Core v May* (1536–37) 432, 436
- Core's Case* (1537) 428, 431, 439, 454, 598
- counterfeit money
  - banknotes 561, 563
  - coins 43, 82, 126, 144, 365, 380
  - foreign currency 30, 380
  - Greco–Roman Egypt 144
  - Medieval bill of payment and 380
  - Medieval Continental Europe 365
  - tender of money and 29–32
  - tendered 29–32
- Cowen, DV 574
- Cramlington v Evans* (1689) 534
- credit card
  - autonomy and 627–8
  - debit card distinguished 65
  - enforcement of paymaster's obligation 61, 64–5
  - law governing 66–7
  - paymaster's obligation 627
  - payment aggregators 603
  - smart card 65–6
    - see also* payment cards
- credit currency 519, 521
- credit risk 492–3
- Crete 79
- cross–border wire–transfer
  - domestic currency 684
- Crouch v Credit Foncier of England* (1873) 351, 461
- Cundy v Lindsay* (1878) 565
- Curcier v Pennock* (1826) 30, 31, 32
- currency 3, 24, 92, 115
  - bank money 561–2, 563–4
  - credit currency 519, 521
  - material negotiability and 554–67
    - meaning 4
  - moneychangers and 125–6
  - national currency 3, 24, 25
  - nature 554–5
  - official currency 3, 21
    - see also* units of account
  - Roman law 111–15
    - debasement 112
    - sterling money 113–14
    - Talmud 92–110, 115
- Currency and Banknotes Act, 1914* (UK) 490
- Currency and Banknotes Act, 1928* (UK) 490, 491
- Currency and Banknotes Act, 1954* (UK) 489, 492
- Currie v Misa* (1875) 22, 489
- Curteis v Geoffrey de St Romain* (1287) 542
- Cutting v Williams* (1702) 534
- Dalhuisen, JH 637–9
- Danks, Ex party. In the Matter of Farley* (1852) 27
- Daube, D 221
- Davies, G 119, 156, 471, 472
- De Roover, R 362, 364, 370–1, 375–6, 383, 392–3, 398, 400, 401, 402, 403, 406, 407, 418, 470, 474, 475
- De Zulueta, F 129, 207, 231, 279, 570
- Dean v James* (1833) 27
- debit card
  - credit card distinguished 65
  - enforcement of paymaster's obligation 61, 65
  - law governing 66, 67
    - see also* payment cards
- Debt *see* bailment of money
- deflation 499
- Dehing, P 364, 367
- Delbrueck v Manufacturers Hanover Trust Co* (1979) 425, 465, 607, 608
- demand deposits 18, 24
- demosiai trapezai* 126, 146
- denarii (pennies) 87–9
- deposit banking 586–7
  - Ancient Greece 125, 126–32, 484
  - Ancient Mesopotamia 120–4
  - Ancient Rome 137–8
  - goldsmith bank system *see* goldsmith bank system
  - Medieval Continental Europe *see* Medieval Continental Europe
- deposit insurance 4, 23, 525
- Detinue *see* bailment of money
- diagraphé* 129, 130, 131



- Dickinson v Shee* (1801) 27  
 Diocletian  
   Price Edict of 301 CE 89  
*Dixon v Clark* (1848) 26  
*Dixon v Willows* (1701) 114  
*Doige's case* (1442) 430–1  
*dotis dictio* contract 223  
*Douglas v Patrick* (1833) 27, 28  
 dud money 112–13  
 Dumoulin, Charles 113  
 Duponchel, J 240–1, 612, 635  
 Dutch East India Company 368  
*dyokani* *see* Talmud
- e-money *see* electronic money  
 Eagleton, C 472  
*Edgar v Chut* (1663) 447  
 Edward I, King of England 470  
 Edward III, King of England 113  
 Edward VIII, King of England 90  
 Egypt *see* Ancient Egypt; Greco–Roman Egypt  
 Einzig, P 20, 74, 79, 120  
 electronic banking 473, 523, 524, 526  
   clearing and settlement systems 496–7  
   EU Payment Services Directive 589, 590, 591, 592, 594, 596  
   funds transfer 41, 60, 65  
   payment mechanisms 64, 587  
   payment orders 5, 24  
 electronic money (e-money) 526, 603  
   definition 594  
   EU E-Money Directive 603  
   EU Payment Services Directive 590, 591, 592, 594  
   institutions 590, 591, 604  
   stored-value card 65, 66, 67, 602, 603  
 electrum 80, 81, 82  
 Elizabeth I, Queen of England 114  
*Emly v Lye* (1812) 480  
*Emperor of Austria v Day and Kossuth* (1861) 490  
*Emptio-venditio* theory 375, 393  
 England 467–9  
   bank money 468–9  
   banknotes 468, 469, 470–81  
   cheques 470–81  
     goldsmith bank system 471–7, 481–2  
     *Vyner v Clipsham* 482  
   Civil War 473–4  
   common law *see* English common law  
   conditional payment principle 625–6  
   Exchequer orders 487  
   expulsion of the Jews 1290 470  
   Glorious Revolution 1688 486  
   Inter-bank co-operation 468  
   interbank clearing 469  
   Jewish money lenders 470  
   London *see* London  
   paymaster's obligation 625–6, 630  
   usury laws 475  
   *see also* Bank of England; English common law; goldsmith bank system  
 English common law 9, 10, 353  
   Account 426–33  
   agency 350  
   assignment of debt 424–5, 464, 465  
   *Assumpsit* 446–8, 449, 462, 464  
     *Indebitatus Assumpsit* 438, 452–3, 454, 455, 456, 462, 465, 536  
   bailment of money *see* bailment of money  
   bill of exchange  
     Admiralty Court 445  
     *Burton v Davy* (1437) 442–5, 449, 543, 672  
     custom and 443–53  
     drawer-parson, liability of 448–9  
     law merchant and 9, 424, 443, 445, 450–3  
     as payee's remedy 442–53  
     reception 442–53  
     relationships among parties 445–6  
   Case, Actions on the 446, 449, 457  
   custodians of chattels 310  
   custom 443–53  
   Debt 425–33, 446, 570, 598–600  
   Detinue 425–33, 558  
   *force majeure* defence 429  
   nominalism 114  
   paymaster's obligation 630  
   *praecipe* writs 425, 446  
   Roman law and 7, 117  
   Writ of Trespass 446  
 Ephron 19, 75, 94  
 Eshnunna, Laws of 121  
*Esses v Friedberg* (2009) 64, 460, 627  
 Etruria 83  
 European Union  
   E-money Directive 603  
   Payment Services Directive *see* payment services  
   Single Euro Payment Area (SEPA) 590  
 exchange bankers 589  
   London 'remitters' 470  
   Medieval Continental Europe 356, 419  
     bills of payment 378–86  
     double exchange transactions 381  
     letters of payment 378, 379  
     merchant bankers 356, 357  
 exchange banks  
   Greco–Roman Egypt 144  
   Medieval Continental Europe 365, 385–6  
 exchange economy 2, 17, 74  
   barter *see* barter  
 exchange rate  
   token denominations 22  
 exchange value 520–1  
 exchangers *see* moneychangers  
 Exchequer orders 487

- Fairs  
 settlement of bills of payment at 375, 377, 382, 419–20  
*Farquharson v Pearl Assurance Co Ltd* [1937] 27  
*Faulkner v Lowe* (1848) 25  
 Feavearyear, A 88, 474, 488, 519, 598  
*Fenn v Harrison* (1790) 480  
 fiat money 21  
 Fifoot, CHS 548–9  
*Finch v Brook* (1834) 27  
 Fischel, WJ 254  
*Fitzroy v Cave* [1905] 50, 425, 530  
 Flanders  
   bills of exchange 442–5  
   Medieval fairs 375  
   *see also* Netherlands  
 Florence 355, 363, 375, 381, 402, 549  
*Foley v Hill* (1848) 43, 50, 351, 454, 558–9, 598–9  
*force majeure* defence  
   English common law 429  
   Roman law 196  
   Talmud 311–12  
*Ford v Hopkins* (1700) 556–7, 559  
 foreign currency  
   banknotes 507, 509  
   central bank and 4–5, 23  
   counterfeit 30, 380  
   national payment system and 4–5, 23  
   obligation payable in 26  
   payment in 26  
   transportation and 43  
   warranty 31–2  
*Foster v Mackimmon* (1869) 564  
 Fox, D 554–5, 556  
 Fox, Fowler & Co, Messrs 490  
 France  
   funds transfers 607, 609  
   *la provision* 461–2, 607  
   meaning 395  
   Medieval bill of payment and 387, 395–6, 417  
   Lyons 375, 381, 382  
   mandate 614–15  
   Medieval fairs 375  
   Paris 375, 496  
   paymaster's obligation 624–5, 636–7  
 Frankfurt-on-the-Main 375  
 funds transfers 650  
   Ancient Greece 117, 124–32, 155–6  
   Ancient Mesopotamia 117, 118–24, 155  
   Ancient Rome 117, 132–9, 155–6  
   cheques *see* cheques  
   credit transfers 40–1, 588, 604, 605, 607, 650, 652  
   France 609  
   Germany 609, 610  
   paymaster's obligation 623  
   Switzerland 609, 610  
   United States 608, 613  
 debit transfers 62, 588, 604–5, 608, 650, 651  
   Germany 609, 610  
   as mandate 612  
   paymaster's obligation 623  
   Switzerland 609, 610  
 electronic 41  
 France 607, 609  
 Germany 609–12  
 Greco–Roman Egypt 117, 140–55, 156–7  
 lack of funds 605  
 modern law 604–12  
 Roman law 117–18  
 Scotland 607  
 Switzerland 609–12  
 Talmud *see* Talmud  
 United States 608–9
- Gaius 129, 225, 231, 570  
*Gaming Act*, 1664 (UK) 575  
 Garcia Morcillo, M 135, 136  
*General Motors Acceptance Corp of Canada Ltd v Bank of Nova Scotia* (1986) 54, 561  
 Geneva 375  
 Geneva Bills Convention *see* Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes  
 Geneva Uniform Laws 580  
*Geniza* of Cairo *see* Cairo *Geniza*  
 Genoa 354, 358–9, 377  
 Gering, L 574  
 Germany  
   bill/note as *literarum obligatio* 571–2, 573  
   conditional payment principle 625  
   Frankfurt-on-the-Main 375  
   funds transfers 609–12  
   Hamburg 402  
   irregular deposit 601–2  
   mandate 615  
   Medieval fairs 375  
   Medieval payment orders 356, 375, 395–6  
   paymaster's obligation 624–5  
   *Wertpapier* 583  
 ghost money 88  
*Giles v Hartis* (1698) 27  
*Gillett v Bank of England* (1889) 510  
 giro systems 41, 46, 58, 60, 61  
   Greco–Roman Egypt 141, 147  
 Glanvill 425, 429  
 Glorious Revolution 1688 486  
 Goitein, SD 280, 291, 295, 300

- gold 33, 34
  - coins 88
    - Ancient Rome 87
    - China 472
    - convertibility 491–2
    - electrum 80, 81, 82
    - Medieval Continental Bill of Payment 381–2
    - Medieval *hawale* 256, 273
    - Middle Ages 89, 112
    - sterling 88, 113
    - Talmud on exchange between gold and silver coins 95, 96, 98–9, 100
  - contract for safekeeping 121
  - inflation and 91
  - as medium of exchange 75, 77, 78
    - Ancient Egypt 140
  - notes backed by 487, 490, 491, 499, 505, 512, 513–15, 519, 522
    - Canada 506, 509–10, 513–15
  - gold standard 22, 23, 491–2, 501, 504
  - Gold Standard Act*, 1925 (UK) 22, 491–2
  - Gold Standard (Amendment) Act*, 1931 (UK) 22, 492
  - goldsmith bank system 21, 352, 469–71
    - banking operations 471–81
    - bill discounting 472, 474–5
    - book-transfer system and 550
    - cheques 471–7, 481–2
    - clearing system 482–3
    - the network 481–4
    - notes 364, 471–81, 487, 488, 489
      - conditional payment principle 478–81, 630–2
    - as money 523
    - paymaster's obligation 630–2
    - as promissory notes 475, 476, 477, 533, 534, 537–41
    - Stop of the Exchequer 1672 478, 487
  - receipts 476
  - Goodwin v Robarts* [1875] 402, 530
  - Gorringe v Irwell India Ruber and Gutter Percha Works* (1886) 425
- grain 74, 76
  - contract for storage 121
  - as medium of exchange 20
    - Ancient Mesopotamia 76, 120, 121, 282
    - Chicago 141
    - Talmud 74, 101
- Granaries
  - Ancient Mesopotamia 120–1, 122, 309, 597
  - Greco-Roman Egypt 140–1, 150, 156
- Grant v Vaughan* (1764) 545, 546, 547, 554
- Grasshof, R 293–4
- Greco-Roman Egypt
  - argyropates* 144
  - banking 117, 140–55, 156–7
  - banks as brokers 143, 156
  - banks leased out to individuals 145
  - banks run by the authorities 142, 145–7
  - basilicon* 146
  - basilikai trapezai* 145–7, 152
  - cheque collection 153–4
  - cheques 8, 149–55, 157, 159, 471, 484
  - collectarios* 144
  - copper 140, 144, 148, 150
  - counterfeit coins 144
  - exchange banks 144
  - funds transfers 117, 140–55, 156–7
  - giro system 141, 147
  - granaries 140–1, 156
  - inter-bank correspondent relationship 153
  - inter-bank transfers 147
  - kollybistikai trapezai* 144
  - komaktores* 144
  - logeutérion* 145, 146
  - money change transactions 144
  - nomarch* banks 146
  - non-cash funds transfers 147
  - payment orders 141, 147–55
  - private banks 143–4, 147, 150
  - public banks 146–7
  - royal banks 145–7, 152
  - Royal Treasury 146
  - State bank 142, 146, 153, 156
  - tax payments 147
  - temple banks 142
  - trapezitai* 143–4
  - village banks 145, 146
  - see also* Ancient Egypt
- Greece *see* Ancient Greece
- Greenback dollars 506
- Greenwile v Slaning* (1616) 438
- Greenwood v Martins Bank Ltd* (1932) 618, 619
- Gregory the Great/Pope St Gregory I 134
- Grelle v Lambert see Baker v Lambert and Grelle v Lambert*
- Gresham's Law 72
- Griffin v Weatherby* (1868) 463
- gross seigniorage 71, 72
  - see also* seigniorage
- Guardians of the Poor of the Lichfield Union v Greene* (1857) 22, 489
- Hale, M 69, 113
- Hall v Fuller* (1825) 618
- Hall v Stevens* (1889) 480, 632
- Hallet's Estate, Re* (1880) 561
- Haly v Lane* (1741) 575–6
- Hamburg
  - bills market 402
- Hammurabi, Code of 20, 76, 121
- Hargrave v Dusenbury* (1823) 30
- Harris Trust and Savings Bank v McCray* (1974) 67, 628

- Harris v De Bervoir* (1624) 438, 439, 454  
*Harry v Perrit* (1711) 537  
 Hart, M'T 364, 367  
*Hartop v Hoare* (1743) 557, 559  
*Hatynes v Beverley* (1379) 435, 440  
*hawale* see Medieval *hawale*  
 Hayek, FA 85, 368, 505, 523  
 Hebrew Bible  
     barter 75, 76  
     money 19–20, 93–4  
 Henry VIII, King of England 90  
*Higgs v Holiday* (1599) 350, 558, 559  
*Hill & Al v Lewis* (1693) 478, 534, 631  
*Hill v Lewis* (1709) 458  
*Hinton's Case* (1682) 544, 545, 546, 554  
*Hodges v Steward* (1681) 453, 531, 532, 544  
 Holden, JM 10, 370, 449, 477, 487, 529, 542, 543, 547, 575, 584  
 holder in due course (HDC)  
     bill of exchange 459–60  
     meaning 578  
     negotiability and 10, 577–8, 580  
 holder not in due course (HNDC)  
     negotiability and 578–9, 580, 581  
 Holdsworth, WA 11, 301–4, 357, 391, 412, 417, 420, 421, 435, 534, 547, 584  
*Holiday v Hicks* (1597 and 1598) 350  
*Hong Kong and Shanghai Banking Corp v Lo Lee Shi* [1928] 510  
*Hopkins v Geary* (1702) 478, 631  
*Hopkinson v Forster* (1874) 548  
*Hoppman v Richard of Welborne* (1302) 542  
*Horton v Coggs* (1689) 544  
 Huna, Rav 105, 106, 330, 634  
*Hussein Mustafa v Osman Ismael* (1909) 269, 271  
*Hussey v Jacob* (1696) 575  
 Huvelin, P 293, 294, 302, 361, 393–8, 400–1, 412–13, 417  
*hypographé* 130, 131  
  
*Imeson, Ex parte* (1815) 489  
*Imperial Ottoman Bank v Limbouri* (1897) 269  
*Indebitatus Assumpsit* see *Assumpsit*  
 India 79  
 inflation 72, 89, 91, 499  
*Imkeepers Case, The* (1369) 450  
 insolvency risk 492–3  
 instruments payable to the bearer  
     negotiation 530, 541–7  
     see also bearer clause  
 insurance  
     deposit insurance 4, 23, 525  
     integrated circuit (IC) card 65  
 interbank clearing and settlement 5, 9, 24, 646, 654, 655  
     APACS 497  
     Bank of England 492–7, 498  
     bills of payment 9, 371  
     central-bank money 493–4, 501, 523–7  
     CHAPS system 497  
     electronic media 497–8  
     England 469  
     goldsmith bank system 482–3  
     joint-stock banks 495–6  
     London Clearing House 494–6, 497  
     Medieval bill or letter of payment and 382, 419–20  
     multilateral 382, 419–20, 495  
     New York Clearing House 496  
     Payment Council 497  
     Real-time gross settlement (RTGS) 497  
     settlement assets 492–5  
 interest  
     prohibition on  
         Islamic law 255, 587  
         Jewish law 96, 159, 169, 587  
     Roman law 195, 198  
     usury laws  
         England 475  
         Medieval Continental Europe 355, 358, 374, 376, 384–5  
 International Chamber of Commerce (ICC)  
     rules  
         letters of credit 62  
 international trade  
     Antiquity and the Middle Ages 83–4  
     barter and 76  
     coins and 83–4  
 irregular deposit 600–1  
     Germany 601–2  
     Italy 602  
     Japan 601–2  
     Roman law 195–201, 309, 310, 432–3, 596–7, 600  
     Switzerland 601  
*Isaack v Clark* (1615) 558, 559  
*Isherwood v Whitmore* (1842) 28  
 Islamic law 7–8  
     deposit taking 253, 254, 255  
     *hawale* see Medieval *hawale*  
     interest, prohibition on 255, 587  
     *jahbads* 254–5  
     negotiability 253, 286  
     remittance of funds 254, 255–6  
     *sarrafs* (moneychangers) 254, 255–6, 277, 281  
     sources 252  
 Israel 75  
*Israel v Douglas* (1789) 438–9, 454, 462, 463  
 Italy  
     cheques 659  
     deposit and transfer banking 359–60, 361, 363, 365  
     Florence 355, 363, 375, 381, 402, 549  
     Genoa 354, 358–9, 375, 377  
     irregular deposit 602

- Italy (*cont.*):  
 mandate 616  
 Medieval fairs 375  
 paymaster's obligation 637  
 Tuscany 363, 549  
 Venice 303, 359–60, 361, 365, 375, 486, 549
- Jackson, RM 435
- James Lamon & Co Ltd v Hyland Ltd* (No 2) [1950] 579
- Japan  
 irregular deposit 601–2  
 mandate 616–17
- Jesus 86
- Jevons, WS 17, 74, 77–8
- Joachimson v Swiss Bank Corp* (1921) 454, 463, 599
- Joint-stock banks 495–6
- Jones Ltd [RE] v Waring and Gillow, Ltd* [1926] 460, 580
- Jones v Ryde* (1814) 30
- Josceline v Lassere* (1714) 535
- Justinian, Emperor 134, 193, 206  
 codification project *see* Roman law
- kârum* 120
- kassiers* 364
- Keene v Beard* (1860) 548, 549
- Kenny v First National Bank of Albany* (1867) 31
- kessef* 19–20, 93–4
- kinyan see* Talmud
- kollybistikai trapezai* 144
- komaktores* 144
- Kremenetzky (Administrator of the Estate) v Anglo-Palestine Bank* 271
- la provision see* France
- Lancashire v Killingworth* (1700) 27
- law merchant 1, 540, 637–9  
 bill of exchange and 9, 424, 443, 444, 445, 449, 450–3, 530  
 cheques 547  
 custom and 443–53
- Lawson, WJ 473, 494–5
- Leatherdale v Sweepstone* (1828) 27
- legal tender 3, 22, 24  
 Bank of England notes 491  
 banknotes 509  
 meaning 25–6, 481, 488
- letter of credit 386  
 autonomy 627  
 confirmation 62  
 enforcement of paymaster's obligation 61, 62–3  
 ICC rules 62  
 nature 62
- letter of payment *see* Medieval bill of payment
- Levin v Rehovot* 271
- Libyan Arab Foreign Bank v Bankers Trust Co* [1988] 40, 465
- Libyan Arab Foreign Bank v Banker's Trust Co* [1988] 465
- Libyan Arab Foreign Bank v Bankers Trust Co* [1988] 523, 525, 599, 608
- Lickbarrow v Mason* (1787) 576–7
- liquidity  
 enhancement 369, 528  
 meaning 71  
 nominalism and 115
- liquidity risk  
 meaning 492–3
- Lisbon 375
- literarum obligation*  
 bill/note as 571–2, 573
- litis contestatio* 223–5, 229, 236, 243, 245  
 Roman law 223–5, 236, 243, 245
- Liversidge v Broadbent* (1859) 461, 463
- Lloyds Bank Ltd 490
- logeutérion* 145, 146
- London  
 bills market 402  
 English banking model 467  
 Exchange Bank of Amsterdam 485  
 goldsmith bank system *see* goldsmith bank system  
 Goldsmiths' Company 473  
 London Clearing House 494–6  
 Medieval bills of exchange 411–12, 442–5, 447–50  
 Medieval exchange banking 470  
 Medieval fairs 375  
 'remitters' 470  
*see also* England
- London Joint Stock Bank v Macmillan* (1918) 564, 612, 619
- Lopez, RS 354, 355
- Louka v Nichola* (1901) 259, 343
- Lowrey v Murrell* (1835) 480, 632
- Lucca 375
- Luffenham v Abbot of Westminster* (1313) 426, 558
- Lydia, Asia Minor 79–81, 82, 84, 85, 86
- Lyons 375, 381, 382
- Macedon 86
- Maharam (Rabbi Meir Lublin) 187
- Maharsha (Rabbi Shmuel Eliezer Edels) 187
- Maharshal (Rabbi Solomon Luria) 187
- Maimonides *see* Rambam
- Malynes, G 398, 402, 403–6, 407, 541, 542–3, 569, 669
- mandate  
 agency and 612  
 bill of exchange 613  
 cheque collection 612

- cheques 612, 618–19
- debit transfers 612
- English law 613–14, 618–20
- France 614–15
- Germany 615
- Italy 616
- Japan 616–17
- meaning of ‘mandate’ 613
- money-back guarantee 621–2
- payment order as 612–22
- Payment Services Directive (PSD) 621–2
- Quebec Civil Code 617–18
- Roman law 201–8, 613
  - liability for *dolus* 203, 614
- Switzerland 614, 615–16
- United States 613, 619, 620–2
- mandatum pecuniae credendae* 213
- Mangles v Dixon* (1852) 425
- Mann, FA 18
- Maor Ha-Gadol (Rabbi Zerachyah ben Yitzchak Halevi of Lunel) 187, 322
- Marcus Aurelius, Emperor 207
- Mardorf Peach & Co v Attica Sea Carriers; The Laconia* [1977] 59, 524, 622
- Marius, J 399, 402, 448, 541, 542, 543, 569
- Martin v Boure* (1602) 447
- Master v Miller* (1791) 425
- material negotiability *see* negotiability
- Maxwell, S 203, 205, 210, 213–14, 219
- Mead v Young* (1790) 567
- Median del Campo 375
- Medieval bill of payment 8–9, 369–87
  - absent money 381
  - bilateral netting 382–3
  - cambium* or exchange contract 372–5
    - currency exchange 373, 374–5
    - dry exchange 373–4, 383–5, 386
    - genus and species distinguished 372–3
    - permutatio* and 372, 373, 375, 393
    - types of monetary exchange 373–4
  - conditional payment 388
  - counterfeit coins and 380
  - credit function 378–9
  - currency conversion 378
  - double-usance* rate 376
  - dry exchange 373–4, 383–5, 386
  - emptio-venditio* theory 375, 393
  - endorsement 377, 401–15, 471
    - autonomy of obligation 416–18
    - bill with payee in blank 403, 405, 406
    - book transfer outside banks and 403, 407–9, 413
    - cessio* and 414–17
    - drawee’s consent to transfer 413
    - effect 411
    - la provision* and 417
    - nature 414–15
    - negotiability and 401–2
    - novatio* and 414–17
    - scope of holder’s entitlement 416–18
    - strict privity and 405, 407
    - transfer of bill before making 403–6, 669
- England 442
- exchange rates 382
- export (trade) bill 666
- extension of credit 378
- as facilitator of trade-finance 379–80
- fairs, settlement at 375, 377, 382, 419–20
- form 377
- half-usance* rate 376
- instrumentum ex causa cambii* 377, 383
- interest charges 376
- issue 377
- la provision* and 387, 395–6, 417
- legal relationships 386, 387–401
  - binding effect of acceptance 399–400
  - French system 395, 396–7
  - German system 396–7
  - la provision* and 387, 395–6
  - liability of drawee–acceptor 395–7, 458–9
  - liability of drawer 393–5, 399–400
  - payee’s recourse against drawer 397
  - privity requirement 391, 392, 397, 398–9
  - Roman law and 388–401
- monies of account 380–1
- multilateral interbank clearing and 382, 419–20
- nature 377
- negotiability, acquisition of 401
- non-transferable 388
- notarial promise to pay 377
- parties 386, 387, 665
- payment obligation 375–6, 377–8
- place of payment 375–6
- present money 381
- remittance bill 667, 668
- reverse bill 380
- usance*, paid at 376, 380
- usury laws and 374, 376, 384–5
- Medieval Continental Europe
  - banco florin 366, 367
  - Bank of Amsterdam 369, 550
    - bank charges 367
    - bill of exchange 367
    - cash withdrawals 368
    - cashiers 367, 368
    - daily settlement 367
    - decline 368
    - deposit and transfer banking 364, 366–7
    - loans 368
    - receipt for deposit 367
  - bank money 361, 365, 366, 367, 369
  - Bank of Sweden 368–9
    - banknotes 368
    - loans 368–9
  - bankers and banking 352–7, 418–19

Medieval Continental Europe (*cont.*):

- banknotes 361, 367, 368
  - banks of circulation 367
  - bill of exchange 290, 357, 362, 365, 401–8, 484
    - Bank of Amsterdam 367
  - bill or letter of payment *see* Medieval bill of payment
  - book transfers 357, 359, 361–3, 369, 549
    - absolute discharge of debt 629
    - as ‘assignment in bank’ 362
    - cheques and 549–50
    - endorsement of bill of payment and 403, 407–9
    - presence-of-all-three requirement 363
    - receptum argentarii* and 361
  - cheques 363–4, 365, 368, 549–50, 659
  - clearinghouses 357
  - coins 361, 365, 366, 367
  - current money 366
  - deposit and transfer banking 8, 355–6, 357–69
    - Bank of Amsterdam 364, 366–7, 368, 369, 550
    - bank money 361, 365, 366, 367, 369
    - Bank of Sweden 368–9
    - banks of circulation 367
    - book transfers 357, 359, 361–3
    - cheques 363–4
    - decline of private banks 365
    - fede di credito* 368
    - fractional reserve 361, 369
    - interbank transfers 360
    - interest 355, 358
    - loans 361
    - moneychangers 355, 356, 357, 358, 364
    - public banks 365–9
    - reserve 361
    - transferable credit instrument 368
    - Tuscany/Florence 363
    - Venice 359–60, 361, 365
  - exchange bankers 356, 419
    - bills of payment 378–86
    - double exchange transactions 381
    - letters of payment 378, 379
    - merchant bankers as 356, 357
  - exchange banks 365, 385–6
  - Genoa 354, 358–9, 377
  - interbank transfers 360
  - merchant bankers 355, 356, 357, 369
    - as exchange bankers 356, 357
  - moneychangers 354, 359, 362, 364, 365, 418
    - as deposit and transfer bankers 355, 356, 357, 358, 364, 369
  - Genoa 354, 358
  - pawnbrokers 355
  - usury laws 355, 358, 374, 376, 384–5
- Medieval *hawale* 7, 256, 344–5
- absolute *hawale* and restricted *hawale* distinguished 273–6
  - bailment of money and 465
  - bearer clause 303
  - bill of exchange and 301–6, 420–2, 464
    - suftaj* 303–6, 421
  - cessio* compared 268, 271–2
  - cheques 278
  - concept 257–8
  - consequences 272–3
  - as contract of surety or guarantee 261
  - creation of binding *hawale* 270–1
  - establishment 261–2
  - Hanafi law 256, 260, 261, 285, 303, 345
    - codification of Hanafi law in the Mejlle 256, 268–76
    - parties to agreement 261–2, 267, 296–7, 465, 659
    - recourse by creditor 263–4, 267, 296, 297–8, 302
    - securities available to creditor 266–7
    - suftaj* 285, 288–9, 296, 297–8, 299, 300–1, 343–4, 345
    - transferee’s defences 265, 266, 267
    - transferee’s indebtedness 262–3, 267, 279–80, 283
  - Hanbali law 260, 261, 300, 343–4
    - parties to agreement 262
    - recourse by creditor 264
    - suftaj* 300, 343
    - transferee’s defences 265–6
    - transferee’s indebtedness 263
  - Islamic payment instruments 277–84
  - in legal doctrine 259–68
  - Maliki law 8, 256, 260, 284, 285, 298, 303
    - Egypt 8, 281, 301
    - negotiable instruments and 304–6
    - parties to agreement 262, 267, 464, 659
    - qirād* 292
    - recourse by creditor 264–5, 267, 296, 297–8, 302
    - securities available to creditor 267
    - suftaj* 285, 292, 296, 299–301, 303–6, 343, 344
    - transferee’s defences 265–6, 267
    - transferee’s indebtedness 263, 267, 282
  - mandate for collection 257–8
  - Mejlle, the 256, 268–76
  - parties to agreement 261–2, 267, 269, 296–7, 659
  - paymaster’s obligation 278–83, 630
    - ruq’a* 278, 279, 282, 283
    - sakk* 278, 279, 282, 283
    - suftaj* 278–9, 290–8
  - recourse by creditor 261, 263–5, 267, 296, 297–8, 302
  - restricted *hawale* 273–6
  - Roman law compared 268, 271–2

- ruq'a* 256, 279, 281–2, 304
  - as cheques 278
  - meanings 277–8
  - paymaster's obligation 278, 279, 282, 283
- sakk* 256, 278, 279, 281–2, 304
  - paymaster's obligation 278, 279, 282, 283
- as sale or exchange 261
- securities available to creditor 266–7
- Shafi'i law 260, 279, 284, 285, 287, 292, 296, 297, 300, 343, 344
  - parties to agreement 262
  - recourse by creditor 264–5
- suftaj* 285, 300, 343, 344
  - transferee's defences 265–6
  - transferee's indebtedness 263
- source 259
- suftaj* 7, 8, 256, 278–9, 342–51, 378, 388, 660
  - bill of exchange and 303–6, 421
  - currency 290
  - formation 284–90
  - geographic distribution 300–1
  - Hanafi law 285, 288–9, 296, 297–8, 299, 300–1, 343–4, 345
  - Hanbali law 300, 343
  - issuers 588–9
  - legal nature 279, 283, 290–9
  - Maliki law 285, 292, 296, 299–301, 303–6, 343, 344
  - Non-transferability 279, 283, 298–9
  - objections 299–301, 343–4
  - operation 290–9, 343
  - paymaster's obligation 278–9, 291–8
  - qirad* analysis 292–4
  - redirection of paymaster's obligation 295–8
  - Shafi'i law 285, 300, 343, 344
  - Talmud and *see* Talmud
  - transferee's defences 265–6, 267
  - transferee's indebtedness 261, 262–3, 267
  - see also* Islamic law
- Meiri (Rabbi Menachem ben Solomon Meiri) 187, 315
- Melis, F 363
- Menger, K 17
- Mercedes-Benz Finance Ltd v Clydesdale Bank plc* (1996) 608, 612
- merchant bankers
  - Medieval Continental Europe 355, 356, 357, 369
- Mesopotamia *see* Ancient Mesopotamia
- Messina 375
- metallic money 72, 77–87, 518, 519
  - Ancient Rome 87
  - Antiquity and the Middle Ages 77–81, 82, 518
  - see also* coins; gold; silver
- metallism 71, 73, 91, 92–3, 110, 519
- Antiquity and Middle Ages 68–9, 71, 72–81, 112
  - banknotes and 521
  - demise 115
  - exchange value 520–1
  - meaning 68–9
  - Roman law and 111–15
  - Talmud and 92, 101–2, 110
  - use value 520–1
- Milan 375
- Miliangos v George Frank (Textile) Ltd* [1976] 26
- Miller v Race* (1758) 92, 109, 111, 460, 488, 489, 518, 546, 555–6, 557–8, 560, 566–7, 576
- Milton's case see Brown v London* (1670)
- monetary base
  - meaning 18, 24
- monetary objects 2, 3, 38, 115, 518–19
  - physical properties 77–8
- scarcity 3, 38
- transportation 38–9, 41, 42, 43, 44, 45, 46, 60, 77, 115
  - see also* banknotes; coins; paper money
- monetary value 3, 9
  - bank money 523–7
  - meaning 16
  - money and 16, 23, 25
  - payment in 16
  - transfer 3
  - transmission 16, 37–9
    - physical transportation 38–9, 41, 42, 43, 44, 45, 46, 60
    - see also* payment mechanisms
- money 9, 17–25
  - as abstract unit of value 18, 19
  - Ancient Mesopotamia 20, 76, 119–20
  - bank money *see* bank money
  - defining 16, 17–18, 23, 481
  - development 2
  - electronic *see* electronic money
  - fiat money 21
  - function 17
  - ghost money 88
  - in Hebrew Bible 19–20
  - Hebrew Bible 19–20
  - in Hebrew Bible 93–4
  - Hebrew Bible 93–4
  - judicial definition 18
  - kessef* 19–20, 93–4
  - monetary value and 16, 23, 25
    - bank money 523–7
  - nature 17
  - payment in *see* payment in money
  - primitive money *see* primitive money
  - scriptural money 523
  - as store of value 17
  - tender of *see* tender of money



- money (*cont.*):  
 as uniform measure of value 18–19  
 warranty as to genuineness 31–2  
*see also* banknotes; coins
- money supply  
 bank deposit and 596  
 meaning 18, 24–5  
 regulation 676
- money transmission  
 meaning 16
- moneychangers  
 currency and 125–6  
 Greco–Roman Egypt 144  
 Islamic world (*sarrafs*) 254, 255, 277, 281  
 Medieval Continental Europe 354, 359, 362, 364, 365, 418  
 deposit and transfer bankers 355, 356, 357, 358, 364, 369  
 Genoa 354, 358  
 Talmud 97, 104–5, 310, 311–12
- trapezitai*  
 Ancient Greece 125–31, 133, 134, 155, 588  
 Greco–Roman Egypt 143–4
- Montpellier 375
- Moral v Karbatzov* 269
- Mordechai (Rabbi Mordechai ben Hillel Hakohen Ashkenazi) 174, 187
- Morgan, EV 484–5
- Morris v Lee* (1786) 576
- Morse v Slue* (1671) 450
- Moss v Hancock* [1899] 18, 481, 524
- Munro, JH 443
- Mycenae 79
- Nachmanides *see* Ramban
- Naples 375
- National Bank of Canada v Tardivel Associates* (1993) 628
- national currency 3, 24, 25  
*see also* currency; official currency
- national payment system 3–4  
 definition 3–4  
 foreign currency and 4–5, 23
- National Westminster Bank v Barclays Bank International* [1975] 613, 618
- natural economy 74
- negotiability 9–10, 12–13, 529, 552–4, 582–4  
 adverse claims, freedom from 554–67  
 bill of exchange 370, 569  
 Continental bill of exchange 401–18  
 contract defences, freedom from 568–81  
 holder in due course (HDC) 10, 577–8, 580  
 holder not in due course (HNDC) 578–9, 580, 581  
 Islamic law 253  
 material negotiability 9, 10, 529, 530, 553–4, 681  
 currency and 554–67  
 Medieval bill of payment 401  
 procedural negotiability 9, 10, 529, 553–4, 681
- negotiable instruments 10, 401–18, 606  
 definition 401, 529, 552  
 parties 682  
 principal features 680  
 Talmud and 351
- negotiation 9, 529, 582–4  
 bills of exchange 370, 529  
 bills payable to order 530, 531–3  
 cheques 530, 547–52  
 English law 552  
 instruments payable to the bearer 530, 541–7  
 meaning 10  
 notes payable to order 530, 533–41  
 transfer of debt 530
- nemo dat quod non habet* 555
- net seigniorage 71, 90, 113  
*see also* seigniorage
- Netherlands  
 Amsterdam Exchange Bank 483  
 cheques 550  
*see also* Bank of Amsterdam; Flanders
- New Brunswick Railway co v British and French Trust Corp Ltd* [1939] 27
- New York Clearing House 496
- Nicholson v Sedgwick* (1698) 544–5
- Nimukei Yoseph (Rabbi Yoseph Chaviva) 96, 99, 101, 102, 109, 172–3, 176, 187, 324, 339
- nomarch* banks 146
- nominalism 68, 71, 92–3, 519, 521  
 Antiquity and Middle Ages 68, 69, 71, 91, 112  
 liquidity and 115  
 meaning 69  
 paper money and 91  
 Roman law and 111–15  
 Talmud and 92, 93, 110
- Non-cash payment mechanisms 3, 26, 38  
 Ancient Greece 128–9  
 Ancient Rome 133, 138  
 foreign currency 26  
 Medieval Continental Europe *see* Medieval Continental Europe
- Non-cash payment services 588–9
- Non-cash payment system 4–5, 24  
 as ‘inverted pyramid’ 5, 23–4
- Northern Ireland  
 banknotes 490
- notes payable to order  
 negotiation 530, 533–41
- Nova (Jersey) Knit Ltd v Kammgarn Spinnerei GmbH* [1977] 573, 579
- novatio/novation see* Roman law
- nummularii* 134–5, 137, 138

- Oaste v Taylor* (1613) 447, 458, 535  
*O'Brien v Grant* (1895) 496  
 Offa, King of Mercia 88  
 official currency 3, 21  
     *see also* currency; units of account  
 Old Testament *see* Hebrew Bible  
*Ontario Bank v Lightbody* (1834) 480, 632  
  
 Palermo 375  
*Palestine Land Development Co v Yalonetsky*  
     271  
 Palma de Mallorca 375  
 paper currency 41, 60  
     *see also* bill of exchange; cheques  
 paper money 38, 505–18, 519  
     Bank of England notes 22, 367, 487–92, 518  
     Canada 506  
     China 471–2, 484, 506  
     circulation 529  
     *see also* negotiability  
     England 470–1, 473  
     Exchequer orders 487  
     goldsmith's notes *see* goldsmith bank system  
     Greenback dollars 506  
     nominalism and 91  
     *see also* banknotes  
 Paris  
     Bankers' Clearing House 496  
     Medieval fairs 375  
 Pawnbrokers  
     Medieval Continental Europe 355  
 Paymaster  
     meaning 3  
 paymaster's obligation  
     absolute discharge 623–7, 629–37  
     assignment of debt and 634–5  
     autonomy 623, 624, 627–30  
     *cessio* 634–5  
     conditional discharge 623–7, 629–37  
     conditional payment principle and 625–6,  
         632–4  
     credit card 627  
     delegation and 629–30, 636  
     enforcement 61–7  
         banker's instrument 63–4  
         beneficiary of letter of credit 61, 62–3  
         cheque 61, 62, 63  
         cheque guarantee card 64  
     England 625–6, 630  
     English common law 630  
     France 624–5, 636–7  
     Germany 624–5  
     goldsmith's note 630–2  
     Italy 637  
     letters of credit 627  
     Medieval Continental bank of deposit 629  
     Medieval *hawale* 278–83, 630  
         *ruq'a* 278, 279, 282, 283  
         *sakk* 278, 279, 282, 283  
         *suftaj* 278–9, 291–8  
     Quebec 637  
     Roman law 629, 630, 634–6  
     Switzerland 636  
     Talmud 633–4  
     United States 626–7, 632–3  
 payment  
     meaning 25–6  
 payment aggregator 603  
 payment cards 64–7  
     access card 65–6  
     clearing and settlement 66  
     consumer protection and 67  
     credit card *see* credit card  
     debit card 61, 65, 66, 67  
     enforcement of paymaster's obligation 61,  
         64–5  
     law governing 66–7  
     smart card 65–6, 602–3  
     stored-value card 65, 66, 67, 602, 603  
*Payment Clearing Systems* (Child Report) 497  
 payment consolidator 603  
 Payment Council 497  
 payment mechanisms 16, 25, 38–9, 60–1  
     banknotes 521–2  
     credit transfers 40–1  
     debit transfers 40  
     electronic 5, 24  
     four-party payment mechanisms 45–7  
         banker payment mechanisms 46, 58–60  
         Correspondent's duties 56–8  
         legal issues 56–60  
         money-transmitter payment mechanisms  
             46, 56–8  
     function 38, 39, 41  
     legal issues 47–60, 645  
     nature 3, 38–9, 60  
     operation 39, 643  
     paymaster's obligation *see* paymaster's  
         obligation  
     three-party payment mechanism 39–44  
         Creditor's right against Paymaster 48,  
             52–4  
         Debtor's discharge 48–9, 54–5  
         legal issues 47–56  
         Paymaster's discharge 49, 55–6  
         Paymaster's duty towards Debtor 48–52  
 payment in money 16  
     appropriation 32–7  
     completion 32–7  
     counting of tendered money 33–7  
     foreign currency 26  
     legal tender 25–6  
     meaning of 'payment' 25–6  
     passage of property 32–7  
     passage of risk 33, 35–7  
     process of payment 32–7

- payment in money (*cont.*):
  - tender *see* tender of money
  - underpayment 33
- payment obligation
  - definition 519–20
- payment services 587–96
  - Payment Services Directive (PSD) 590–6
    - capital requirements 593
    - definition of ‘payment services’ 594
    - exclusions 594–5
    - money-back guarantee 621–2
    - payment-service providers 590–3
    - permitted activities 593
  - providers 587–9, 590–3
  - risk 589
  - users 587
- payments in kind
  - Carolingian Empire 87
  - Talmud 74
- Peacock v Rhodes* (1781) 576
- Pearson v Garrett* (1693) 535
- pecunia* 76
- penny 87–9, 112
- Pepin the Short, King of the Franks 87–8
- permutatio* 372, 373, 375, 393
- Persia *see* Ancient Persia
- Petit v Benson* (1697) 574
- Philip of Macedon 84
- Phoenicia 75, 76, 83
- Pirton v Tumby* (1315) 434
- Pisa 375
- Pitman v Walker* (1922) 573
- Plato 17
- Pnei Moshe (Rabbi Moshe Margalioth ben Shimon) 178, 179, 187–8
- Polo, Marco 471
- Pope v Leiger* [1694] 114
- Post-Talmudic Jewish law sources 186–9
- Pothier, RJ 200, 613, 618–19
- Pott v Clegg* (1847) 598
- praecipe* writs 425, 446
- praeco* 136
- pre-paid card 602
- precious metals 19, 20, 75, 76, 77, 78
  - see also* gold; silver
- presence-of-all-three requirement
  - Medieval banking book transfers 363
  - Talmud *see* Talmud
- primitive money 20, 73, 74–5, 518, 519
  - Ancient Mesopotamia 120
  - caravan trade 76–7
  - definition 20, 75
  - drawbacks 76–7
- procedural negotiability *see* negotiability
- promissory notes 10, 317, 319, 476
  - Bank of England Notes as 533
  - banknotes as 507–18, 533
  - definition 508
  - goldsmiths’ notes 475, 476, 477, 533, 534, 537–41
  - legislation 507–11
- Promissory Notes Act, 1704* (UK) 536, 537, 540–1, 545–6
- provision, la see* France
- Puget de Bras v Forbes* (1792) 577
- Quebec Civil Code *see* Canada
- Queen v Brown* (1854) 510
- R v Preddy* [1996] 525, 608
- R v Williams* [1942] 535
- Raavad (Rabbi Avraham ben David) 188, 319
- Rabbah 161, 165, 171, 172–5, 176–9, 180, 182, 184
- Rambam (Rabbi Moshe ben Maimon, Maimonides) 104, 107, 188, 189, 312, 318, 319, 324, 338–9, 571
- Ramban (Rabbi Moshe ben Nachman, Nachmanides) 104, 109, 188
- Ran (Rabbi Nissim ben Reuven) 188
- Randolph v Abbot of Hailes* (1313–14) 444
- Range v Belvédère Finance Corp* [1969] 541
- Rann v Hughes* (1778) 538, 572
- Raphael v Bank of England* (1855) 510
- Rashba (Rabbi Shlomo ben Aderet) 188, 319–20, 322, 324, 328, 337
- Rashi (Rabbi Shlomo ben Itzhaki) 74, 93, 99, 100, 102, 103, 104, 108, 188, 189, 309, 317, 323, 327, 597
  - commentary on *Bava Metzia* 161–2, 164, 173, 184
- Rasht v Morris* (1919) 31
- Rationes*
  - Ancient Rome 138
- Rava 102, 107, 315, 331, 335, 336
- Ray, ND 285, 286, 295
- Rayner, JH v Hambro’s Bank* [1943] 290
- Re Alberta Legislation* [1938] 26
- re-coinages 90–1
- receptum argentarii* 210, 211, 213, 214, 229, 230, 361, 582
  - Medieval bill of payment and 389, 390, 391
  - paymaster’s obligation 629
- Remde, A 293, 294
- rescission for mistake 31
- Richards, RD 482, 547
- Ridvaz, the 179
- Riedell v Commercial Bank of Australia* [1931] 612
- Rif (Rabbi Isaac Alfasi) 96, 99, 101, 102, 104, 109, 163, 180, 187, 188, 316, 322, 323, 324, 328, 339, 340
- Ritva (Rabbi Yom Tov ibn Asevilli) 189
- Robinson v Cook* (1815) 27
- Robsert v Andrews* (1580) 438
- Roby, HJ 219, 220, 225, 234

- Rogers, JS 11, 12–13, 443–4, 449, 451, 484, 540, 543, 561–3, 584, 640
- Roman law 7, 8, 117, 191–4  
 assignment of debt 238–41  
 autonomy 629, 630  
 bailment of money and 432–3, 465, 596–7  
 bill of exchange and 117, 251, 418  
*cambium* contract 372  
*cessio/cession* (assignment) 219, 233–41, 246–8, 334, 362, 582, 656  
*assignatio* distinguished 240–1, 612, 635  
 bill of exchange 414–17  
 categories of assignment 238–9  
 codification project of Justinian 237  
*litis contestatio* and 235–6  
 Medieval bill of payment and 391, 394, 396  
 Medieval *hawale* compared 268, 271–2  
 paymaster's obligation 634–5  
 circulation of credit 242–3, 302–3, 306, 532–3, 657  
 civil codes and 117  
 codification project of Justinian 193, 196, 206, 218, 219, 246, 361  
 cession 237  
 circulation of credit 243  
 delegation 219, 229–33, 246–7  
 literal contract 225, 226  
 stipulation 218–19
- coins 111–15  
 demonitized 112  
 dud money 112–13  
 substance and quantity distinguished 113
- compensation 206–8, 222–3
- constitutum debiti alieni* 210, 211–14, 229, 230, 232  
 Medieval bill of payment and 389–90, 391  
 paymaster's obligation 629
- contracts 193  
 bilateral 193, 194, 196, 198, 202, 203, 206, 213, 222  
*bonae fidei* 194, 196, 202, 213, 226  
 consensual 193, 194, 196, 202, 212, 213  
*dotis dictio* 223  
 formal 194, 195, 210, 213, 214, 221, 226, 230, 231–2, 570  
 for hire 202  
 informal 194, 195, 202, 213, 217, 230, 232  
 literal 193, 194, 195, 202, 207, 210, 225–9, 570  
 mandate 201–8, 613  
 oral 214, 230–1  
 pledge 195  
 privity 204, 205, 214, 216  
 real 193, 194, 195, 202, 212
- reform under Justinian 229–32  
*stricti juris* 193–4, 195, 196, 198, 207–8, 213, 214, 221, 223, 226, 230, 265, 395, 570, 571  
 unilateral 193, 194, 195, 196, 198, 207, 213, 214, 221, 223, 226, 230, 231, 570  
 verbal 193, 194, 195, 202, 210, 213, 214, 221, 223, 230  
 written 230–2
- currency 111  
 debasement 112
- debt circulation 582
- debt owed by Paymaster to Debtor 194–201  
 allocation of risk 199, 250  
*commodatum* (loan for use) 195, 196, 197  
*depositum* (deposit) 195, 196, 197, 429  
 interest 195, 198  
 irregular deposit 195–201, 596–7  
*mutuum* (loan for consumption) 11, 195, 197, 198, 199, 200, 201
- delegation (*delegatio*) 192, 246–51, 464, 612, 636, 656  
 codification project of Justinian and 219, 229–33, 246–7  
 definition 268  
 paymaster's obligation and 636
- delegation order 192, 246, 582  
 compensation 206–8  
 as *jussus* 203, 204–5  
 legal nature 201–8  
 as mandate 201–8
- English common law and 7, 117
- executing the delegation 208–10  
 acknowledgement of entry posted to 'Codex Accepti et Expensi' 225–9  
*constitutum debiti alieni* 210, 211–14, 229, 230, 232, 389–91, 582  
 imperfect execution 210–14, 388, 389  
*litis contestatio* 223–5, 229, 236, 243, 245  
*mandatum pecuniae credendae* 213  
 Medieval bill of payment and 389–90  
 novation other than by stipulation 223–9  
 novation by stipulation 214–23, 390–1  
 perfect execution 214–29, 388, 389  
*receptum argentarii* 210, 211, 213, 214, 229, 230, 361, 389–91, 582  
 sub-delegation 388–9
- force majeure* defence 196
- funds transfers 117–18
- genus and species distinguished 372–3
- heritage 246–51
- influence 117–18, 246–51
- interest 195, 198
- irregular deposit 195–201, 309, 310, 432–3, 596–7, 600
- litis contestatio* 223–5, 229, 236, 243, 245  
*cessio* and 235–6
- loan for consumption 111

Roman law (*cont.*):

- mandate 201–8, 613
  - as bilateral, *bonae fidei* contract 202
  - definition 201–2
  - delegation order as 201–8
  - liability for *dolus* 203, 614
  - mutual obligations 202
- Medieval bill of payment and 388–401
- Medieval *hawale* compared 268, 271–2
- monetary legal theory 111–15
- mutuum* (loan for consumption) 11, 111, 195, 197, 198, 199, 200, 201
  - cum stipulatione* 217
- nominalism 111–15
- novatio*/novation 334, 582
  - bill of exchange and 414–17
- novation other than by stipulation 223
  - acknowledgement of entry posted to ‘*Codex Accepti et Expensi*’ 225–9
  - litis contestatio* 223–5, 236, 243, 245
- novation by stipulation 390–1
  - enforceability by Creditor of Paymaster’s undertaking 214–17
  - scope and impact of Paymaster’s undertaking 217–23
- paymaster’s obligation 629, 630, 634–6
- payment to distant party 244–6, 302–3, 391, 658
- re-cession (re-assignment) 243, 280, 306, 657
- re-delegation 8, 243, 280, 306, 532, 657
- real contract 193, 194
- receptum argentarii* 210, 211, 213, 214, 229, 230, 361, 582
  - Medieval bill of payment and 389, 390, 391
  - paymaster’s obligation 629
- spread 7
- stipulatio*/stipulation 195, 198, 212–13, 571, 582, 656
  - auctions 216–17
  - formation 214–15
  - Medieval bill of payment and 390–1
  - mutuum cum stipulatione* 217
  - nature 214
  - novation by 214–23
  - oral contract 214, 230
  - paymaster’s obligation 629, 630
  - written contract 232
  - written obligations 570–1
  - see also* Ancient Rome
- Rome (city) 375
- Rosh (Asher ben Yechiel) 104, 174, 180, 189, 320, 340
- Rouen 375
- royal banks
- Greco-Roman Egypt 145–7, 152
- Royal Products Ltd v Midland Bank Ltd* (1981) 58, 619
- ruq’a* *see* Medieval *hawale*

*sakk* *see* Medieval *hawale*

- Sale of Goods Act* 1893 (UK) 565, 566
- Sale of Goods Act* 1979 (UK) 32
- Sale of Goods Act* 1990 (Ontario) 239
- Salman v Barkyng* (1422) 570, 630
- Scholfield v Earl of Londesborough* (1896) 618–19
- Scotland
  - assignment 240
  - banknotes 490
  - bills of exchange 607
- Scott v Surman* (1742) 53, 351, 559
- scriptural money 523
- scriveners 470, 482
- Scruggs v Gass* (1835) 480, 632
- sea loans 383
- seigniorage 494
  - Antiquity and the Middle Ages 71
  - gross seigniorage 71, 72
  - net seigniorage 71, 90, 113
- Selangor United Rubber Estates v Cradock* (No 3) [1968] 612
- Self-sufficiency 17, 74, 78, 640
- Serca Foodservice Inc v Canadian Imperial Bank of Commerce* [2000] 628
- Serle v Norton* (1841) 548
- set off 16
- Seville 375, 381
- Shand v Du Buisson* (1874) 461
- Shaw v Norwood* (1600) 437–8
- shekel 75, 85
- Shelden v Hentley* (1681) 544
- Shesheth, Rav 161, 165, 171, 172–5, 178, 179, 180, 182, 185
- shetar* 317–18, 321, 571
- shilling 88
- Shmuel 326, 328–9
- Shulchan Aruch (Rabbi Josef Karo) 104, 189, 304, 316, 318, 329, 334, 341, 347, 571, 634
- Siena 375
- Silver
  - Ancient Mesopotamia 120, 121, 122
  - coins 82
    - Ancient Rome 83, 87
    - black money/billon 89, 382
    - denarii/pennies 87–9
    - electrum 80, 81, 82
    - Greco-Roman Egypt 140, 149
    - Medieval Continental Bill of Payment 381–2
    - Medieval *hawale* 256, 273
    - Talmud on exchange between gold and silver coins 95, 96, 98–9, 100
  - contract for safekeeping 121
  - inflation and 91
  - kessef* 19, 93–4
  - as medium of exchange 19, 20, 75, 76, 77, 78, 120, 121, 122

- sterling 88, 113
- supplanted by gold 491
- Simmons v Swift* (1826) 37
- Simms v Clark* (1849) 31
- Simon, Ethnarch of Judea 86
- Sinclair v Brougham* [1914] 559
- Single Euro Payment Area (SEPA) 590
- Sir George Walgraces Case* (1606) 428, 558
- Slade's Case* (1602) 447, 454
- small change 18, 24
  - Ancient Greece 125
  - Antiquity and the Middle Ages 72, 89–90
- smart card 65–6, 602–3
- Smith, Adam 19, 505, 506
- Solomon 76
- Solon 90
- Southcote v Bennet* (1601) 429
- Spain
  - Medieval fairs 375
  - Seville 375, 381
- Sproat v Matthews* (1786) 574
- standard formula 22, 73
- Starke v Cheeseman* (1700) 452–3, 569
- sterling 88, 113–14
- stipulatio*/stipulation *see* Roman law
- Stocks v Dobson* (1853) 50
- Stop of the Exchequer 1672 478, 487
- stored–value card 65, 66, 67, 602, 603
  - see also* payment cards
- stored–value product (SVP) 602, 603
- Street, TA 534
- stricti juris* contract 193–4, 195, 196, 198, 207–8, 213, 214, 221, 223, 226, 230, 265, 395, 570, 571
- Sub nom Bank of Montreal v Bay Bus Terminal (North Bay) Ltd* (1972) 514
- Suckling v Coney* (1598) 27–8
- Suffell v Bank of England* (1882) 510
- suftaj see* Medieval *hawale*
- Sweden
  - Bank of Sweden 368–9, 472
- Switzerland
  - Code of Obligations (CO) 241, 583, 601, 609–12, 615–16, 636
  - funds transfers 609–12
  - irregular deposit 601
  - mandate 614, 615–16
  - Medieval fairs 375
  - paymaster's obligation 636
- syngraph* 129, 231, 279, 304, 318, 570, 582
- Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd* [1986] 619
- Tailby v The Official Receiver* (1888) 50, 425, 541
- Talmud 6–7, 8, 117
  - asimon* 99–100
- bailment of money and 432–3, 597
  - zechi* compared 464–5
- bank deposit 597
- barter 97–8, 110, 303, 313, 314, 317
- bearer clause 320
- bill of exchange and 319, 351
  - zechi* compared 464–5
- chalifin* 97–8, 110, 303, 313, 314, 317
  - kinyan sudar* 98, 313, 314
- cheques 7, 117, 130, 158–61
  - Bava Metzia* 161–5
  - credit extended by paymaster 160, 161–5, 172–3
  - money change transactions 161–4
  - oral system 159
  - other commentators on *Bava Metzia* 172–5
  - renunciation of recourse 160, 165–72, 173–5, 176–8, 179–84
  - Shevuot* 178–84
  - Tosafo's commentary on *Bava Metzia* 165–72, 174, 176–8
- coins 19, 93
  - bad coins 99–100
  - circulation 92, 93, 96, 100, 107–10
  - damage/deterioration 96
  - exchange 94–5, 375
  - money change transactions 94–5, 97–101
  - as money and ordinary chattels 96, 97–101
  - property rules 107–10
  - stamped figure/image 93, 96
- coins valued on basis of metal 100, 101–3
  - bad coins 99–100
  - deficient coins as money 103
  - demonitized 103, 105, 106–7, 109
  - erosion beyond the limit of fraud 102, 105–7
  - erosion to the limit of fraud 102, 103–5
  - time limit for defrauded party 104–5
- conditional payment principle and 351
- currency 92–110, 115
- despair rules 107, 108
- dyokani* 8, 326–9, 349, 663
  - proper appointment 327, 328
  - suftaj* and 348–50, 664
  - turning creditor's agent to paymaster 326–9
  - witnessed appointment 326, 328
- force majeure* defence 311–12
- funds transfers 8, 117, 307–8, 350–1
- presence-of-all-three declarations 319–20, 330–42
  - remitting coins to a distant place 342–50
  - transfer of ownership in money owed 309–30
- grain as medium of exchange 74, 101
- history 6–7, 158
- interest, prohibition on 96, 159, 169, 587

Talmud (*cont.*):*kinyan*, act of

renunciation of recourse 166, 168, 170, 171, 177

transfer of chattels 312–13

*kinyan agav karka* 315*kinyan sudar* 98, 313, 314

## loan transactions 96

credit extended by paymaster 160, 161–5

interest 96, 159, 169

Jewish debtor/non-Jewish creditor 169

metallism and 92, 101–2, 110

monetary legal theory 92–110

money 95–6

binding in the hand 95–6

as medium of exchange 96

money change transactions 94–5

*asimon* 99–100

bad coins 99–100

*Bava Metzia* 161–4

coins as money and ordinary chattels 96, 97–101

coins valued on basis of metal 100, 101–7

legal nature 97–101

money owed on loan or deposit 309–12,

432–3, 597

bound-up coins 310

custodians of chattels 310–12, 432

deposit of money in open bag/sealed bag 310, 597

mixed deposits 309–10, 433, 597

moneychangers 97, 104–5, 310, 311

negotiable instruments and 351

nominalism and 92, 93, 110

*oditta* 314–16, 329, 335, 342, 348, 349, 661

oral loans 316–17, 321, 342

paymaster's obligation 633–4

payments in kind 74

post-Talmudic Jewish law sources 186–9

presence-of-all-three declarations 319–20, 330–42

binding effect of transaction 334, 341

debtor's power to renounce right towards beneficiary 333, 334, 338–9

effect 333–4, 336

effectiveness 332–3

gifts 340

irrevocability of instruction 334, 341

*oditta* and 335

paymaster's consent 333, 334–5, 336–7

recourse against debtor 333, 334, 339–42

*zech*i and 335–6

## property rules

coins 107–10

despair 107, 108

finding of chattels 107

stolen objects 107–8

'Rabbi Nathan's lien' 316, 346–7

remitting coins to a distant place 342–50

renunciation of recourse 160, 165–72, 179–84

express conditional discharge 171, 172,

173–5, 176–8, 181, 183, 184, 185

implied absolute discharge 167, 171,

172–3, 174–5, 180, 181, 183, 185

implied conditional discharge 185

*kinyan*, act of 166, 168, 170, 171, 177

Tosafot's commentary on *Bava Metzia*

165–72, 174, 176–8

*shetar* 317–18, 321, 571

status 6–7

*suftaj*, use of 8, 345–50, 351, 638

*dyokani* and 348–50, 664

*urcheta* and 348

transfer of ownership in money owed

*chalifin* 97–8, 313

direct mechanisms for transfer 312–21

*dyokani* 8, 326–9, 348–50, 663

*kinyan*, act of 312–13

*kinyan agav karka* 315

*kinyan sudar* 98, 313, 314

money owed on loan or deposit 309–12

*oditta* 314–16, 329, 335, 342, 348, 349, 661

oral loans 316–17, 321, 342

*shetar* requirement 317–18, 321

transfer of documentary note of

indebtedness 304–5, 317–21, 351, 571

*urcheta* 8, 321–6, 330, 662

*zech*i 314, 316, 329, 335–6, 342, 348, 349,

464–5, 661

*urcheta* 8, 321–6, 342, 662

effect 322, 324–5, 326, 330

nature and operation 321–2

scope 322–4, 325–6, 330

*zech*i 314, 316, 329, 342, 348, 349, 661

bailment of money compared 464–5

bill of exchange compared 464–5

presence-of-all-three declarations, and 335–6

*Tassell and Lee v Lewis* (1695) 22, 451, 478,

525, 533, 537–8, 539, 631

*Taylor v Plumer* (1815) 53, 561, 562

## temple banks

Ancient Greece 125, 142

Ancient Rome 133–4

Greco-Roman Egypt 142

## tender of money

acceptance of tender 32–3

allocating risk of shortfall 29–32

counterfeit money 29–32

counting of money 28–9, 33–7

effective tender 27

fraud 30

meaning of 'tender' 26–7

mistaken overpayment 29, 33

money in bags 27–32

plea of tender 26–8

- rejection rights 33
- sufficient tender 27, 28, 29
- time of tender 28
- unaccepted tender 27
- underpayment 29–31, 33
- see also* payment in money
- Thames Sack and Bag Co Ltd v Knowles & Co Ltd* (1918) 32
- Thomas v Evans* (1808) 27
- Thomson v Clydesdale Bank Ltd* [1893] 54
- Tinckler v Prentice* (1812) 28
- Toronto Beaches Election, Ferguson, Re v Murphy* (1943) 510
- Tosafot 99, 100, 189, 309, 323, 328, 335, 336, 338, 349
  - commentary on *Bava Metzia* 165–72, 174, 176–8
- Tosafot Yom Tov (Rabbi Yom Tov Lipman Halevi Heller) 189
- Tourville v Nash* (1734) 572
- Toynbee, Arnold 81, 85, 86, 471–2
- Toynbee, JMC 86, 133
- trade acceptance 579, 674
- trapeze*
  - Ancient Greece 126, 127, 128–32
- Trapezitai*
  - Ancient Greece 125–31, 133, 134, 155, 588
  - Greco-Roman Egypt 143–4
- Treseder-Griffin v Co-operative Insurance Society Ltd* [1956] 89
- Trover 555, 558
- Trueman v Hurst* (1785) 576
- Tur (Rabbi Jacob ben Asher) 162, 165, 175, 187, 189, 304, 318, 329, 331, 334, 340, 351, 571
- Turberville v Stamp* (1697) 450
- Tuscany 363
- Udovitch, AL 304
- United States
  - Chicago 141
  - conditional payment principle 480, 632–4
  - funds transfers 608–9
  - grain banking 141
  - Greenback dollars 506
  - mandate 613, 619, 620–2
    - money-back guarantee rule 621, 622
  - New York Clearing House 496
  - paymaster's obligation 626–7, 632–3
  - uniform, credit transfers 608, 613
  - Uniform Commercial Code*
    - assignment by way of security 239
    - bill of exchange 370
    - conditional payment principle 480
    - funds transfers 608–9
    - holder in due course (HDC) 578, 580
    - mandate 613, 619, 620–2
    - money-back guarantee rule 621, 622
    - paymaster's obligation 626–7
    - promissory notes 508, 510
    - rule in *Mead v Young* (1790) 567
- units of account 21–2
  - coins 19, 21, 69
  - exchange rate 22
  - monetary 21
  - national 21, 23, 24
  - standard formula 22, 73
  - tokens 73
  - value 21
  - weight units 19, 21
- urcheta see* Talmud
- use value 520–1
- Usher, AP 364
- usury laws
  - England 475
  - Medieval Continental Europe 355, 358, 374, 376, 384–5
  - see also* interest
- utopian societies 17
- Valencia 375
- Vandorpe, K 140
- Venice 303, 359–60, 361, 365, 375, 486, 549
- village banks
  - Greco-Roman Egypt 145, 146
- Vyner v Clipsham* 482
- Wade's Case* (1601) 27, 28, 29, 30–1
- Wait v Barker* (1848) 32
- Ward v Evans* (1702) 22, 458, 478–9, 631
- Warren, WR 530
- Warwick v Nairn* (1855) 579
- Ways and Means Act, The*, 1694 (UK) 485, 487
- weight units
  - coins and 19, 21
  - see also* units of account
- wergeld* 19
- Wertpapier* 583
- Westermann, WL 124, 132
- Western Canada Pulpwood and Lumber Co Ltd, Re* [1929] 32
- Wharton v Walker* (1825) 463
- Whitecomb v Jacob* (1711) 351
- Whorewood v Shaw* (1602) 438, 439
- William Brandt's Sons & Co v Dunlop Rubber Co Ltd* [1905] 50
- Williams, J 472
- Williams v Everett* (1811) 462
- Williams v Field* (1694) 451, 531
- Williams v Williams* (1693) 534
- Wingate v Neidlinger* (1875) 30, 31
- Woodhouse AC Israel Cocoa Ltd SA v Nigerian Produce Marketing Co Ltd* [1971] 26
- Woodhouse Ltd v Nigerian Product Ltd* [1971] 380–1



*Woodward v Rowe* (1666) 451

World War I 490

*Wright v Reed* (1790) 489

Yachin U'Voaz (Rabbi Yisrael Lipschutz) 189

*Yan v Post Office Bank Ltd* [1994] 460

Yehuda, Rabbi 74, 104

Yochanan, Rabbi 326, 328, 349

*Young v Adams* (1810) 30, 31

*Young v Grote* (1827) 618, 619

*zechi* see Talmud